AN INTRODUCTION

TO THE STUDY OF

INDIAN ECONOMICS.

Vol. II

BY THE SAME AUTHOR.

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AN

INTRODUCTION

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BY

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PREFACE

The first Volume of this work was ready, printed, by the end of March, and this, the second Volume, is out of the press to-day, the [redacted]ne, [redacted] The two Volumes are being issued together. Advantage has been taken of the above interval to introduce into the second Volume the latest facts and figures relating to the trade, currency, banking and finances of India ; and even a summary of Mr. W. T. Layton's recommendations relating to the reorganization of Indian finance on a federal basis, has been given in Appendix II at the close of the second Volume. Though both the size and the bulk of the work have been increased, the old price, Rs. 10 for the two Volumes, has been retained for the benefit of the student world in India.

Durgâdhivâsa, Poona 4
30th June,[redacted]

V. G. KALE.

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THE CURRENCY SYSTEM.

165. Money :—The lively an unflagging interest with which monetary problems have been discussed in India during the last many years, demonstrates the vital importance of a sound currency system to the well-being of a nation and the public consciousness that the currency arrangements developed in India, have suffered from serious drawbacks. The interlacing and the dependence of economic phenomena is instructively reflected in the relation of money to prices, capital, wealth-production, incomes, trade and finance; in fact, in the whole complex of the national life of a modern community. Money is often incorrectly regarded by the uninstructed as an indication of wealth and prosperity; nevertheless, the fact of its being a measure of value and the instrument of exchange, imparts to it a significance all its own. Economists[1] have advanced various theories in relation to the essence of money. Some look upon it as nothing more than an ordinary commodity, others treat it as a mere index of value, a ticket, and still others divorce the value of money completely from the substance of which it is made and make it a creature of law. They are known as the metallic, conventional and State theories of money. There is an element of truth in all these theories, an understanding of which will prove extremely useful in discussing the monetary problems of India. In passing we may refer to the organic conception of money presented by some thinkers e.g. by O. Spann, who regards money as "capital of a higer order"—as the truest and the ever-present phenomenon of the communal and governmental assistance rendered to economic activities."[2] We shall begin with a few elementary facts and considerations.

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1 See Wolfgang Heller: "Die Entwicklung der Grundprobleme der Volkswirtschaftlichen Theorie."

2 See "Fundament der Volkswirtschaftslehre."

The inconvenience associated with barter leads to the selection of one or more objects as means of payment, that is to say, to be given and received in exchange for commodities. What every person, seller and purchaser of goods, seeks is wealth in various forms adapted to consumption. But to secure them he must, each time, give in exchange objects that will be acceptable in quality and quantity to the other party. A cultivator may take a basket of rice to a clothier's shop with the intention of purchasing a shirt. But how is he to know how much he is to pay for different kinds of shirts? The seller of shirts may likewise possibly have enough of rice in his house and not need what is offered. Difficulties of this nature involved in the measurement of values of commodities and in effecting bargains, are overcome if a common measure of value and means of payment is agreed upon and all values are determined in relation to it. Bulky and perishable objects or articles which are not easily divisible, are not suited to become means of payment which may be of small or large size. Domestic animals, cows, bullocks and sheep may be used as means of payment and measures of values in agricultural and pastoral communities, but economic development calls for the selection of other and more suitable objects; and shells, cowries, bits of leather, seeds, and hard, dried fruit thus come into use. The metals, copper, silver and gold, best satisfy the requirements of a convenient means of payment and a measure and a store of value, and have been invariably adopted by mankind even at earliear stages of social progress. In any event, when a 'market' is developed and a common price ensues, money becomes indispensable.

Whichever metal or metals might be used, they had to be weighed out in order to measure and fix the values of goods; and when payment in the form of ingots or bars was found inconvenient, discs or square pieces of a definite weight and size were introduced. The values of the pieces were guaranteed by the stamps imposed on them by public authority; and thus coined 'money' came into general use.[1] Intrinsic value is an accompaniment but not an essential characteristic of money. The substance of which money is made, gold or silver, for instance, may be used as bullion in the arts, and its inde-

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1 "So long as a given material is *per se* a means of payment money has not yet come into being."—Knapp: The State Theory of Money.

pendent commodity value is important in the eyes of the public. Money made out of the precious metals thus inspires confidence in the minds of users, but equally good money is made out of paper which has no value of its own. The sovereign authority of the State ordains the metal which will form the substance of the principal means of payment and prescribes the units of value which this money will represent. Money is, therefore, largely a creature of law; and its validity is independent of the material it is made of and is derived from the authority of the State. All means of payment are not money in the strict sense of the term but the reverse is true. Law fixes, in each country, the metal, the quality and the quantity and the value of the standard money; and the State undertakes to issue this money from its mints to the public in exchange for definite quantities of bullion tendered. The acceptance of this standard money is made obligatory by law. Besides standard money, subsidiary or fractional money is issued by the State for enabling the public to effect small payments, but it is not freely coined like standard money and its relative value is arbitrarily fixed. The obligation to receive the subsidiary money is also limited to small amounts. Bank notes are useful means of payment and become money by being recognized as such by the State; and treasury or currency notes are accessory money as they are issued by the State.

The money of each country, particularly paper money, circulates only within its borders; it will be accepted in other countries only at its intrinsic value, the face value depending on the fiat of the State, which is not recognized elsewhere. Before the war, the leading nations of the world had come to adopt gold as the standard metal out of which the chief money was coined at the State mints. During and long after the close of the war, the system of the gold standard was practically, though not theoretically, abandoned by all of them except the United States of America. Money based upon the gold standard, has the characteristic of international money because the conversion of one nation's currency into another's is easily effected under the system owing to the universal demand for the yellow metal. The Indian currency system has had a long and chequered history, and a novel monetary standard was developed in this country with a view mainly to facilitate foreign exchanges. It was the gold exchange standard which is a modified form of the gold standard. Under this system gold is nominally the standard, but it is

neither minted nor is it in free circulation, there being no obligation on government to redeem the silver and paper money in gold. We shall now proceed to trace the stages through which the Indian system of currency has passed before reaching its present position. The question of foreign exchanges, which is intimately bound up with it, will, for the sake of clearness, be separately dealt with in the next chapter. It will be discussed in the present chapter so far as it is necessary for the exposition of the monetary system, the subject under immediate consideration.

166. Monetary Standard:—A few more preliminary observations will be helpful in the elucidation of this complicated topic. Money is the means of payment created and enforced by the authority of the State, and its validity and value are independent of the substance of which it is made. As it is one of the functions of the State to see that voluntary contracts between individual citizens are properly respected and carried out, it has to prescribe the means of paying debts that it will accept and will compel other creditors to accept from debtors. Nevertheless, these means must inspire public confidence, and hence the use of gold and silver in their manufacture. Money is indeed intended and mainly destined to be parted with; but unlike the inch or the foot, it is a store as much as a measure of value and may be used as a consumption good also. These facts have to be specially borne in mind in dealing with Indian conditions. The metal of which the definitive kind of money is made and the weight and the fineness of the monetary units are authoritatively fixed; and the State undertakes to issue from its mints (this is its exclusive prerogative) the standard coins in exchange for the fixed quantities of the standard metal. The money thus freely coined without limit (the fee levied is insignificant) is called specie. The monetary system of each country includes, besides this class of money which is its basis, others which do not share these peculiarities. Thus some classes of accessory money made of metal or paper, are not freely issued and may or may not be tenderable in unlimited quantities in payment of debts. Similarly, fractional money or small change is 'legal tender' only up to a small fixed limit and there is no free coinage in its case. Currency systems are distinguished according to the metal which forms the substance of the principal, absolute or specie money and which is known as the standard. The British system of currency is thus based on the gold standard, and

the sovereign or the pound sterling is the principal money possessing the special characteristics mentioned above. Any one presenting an ounce of gold, is entitled to receive from the Royal Mint £ 3 17 s. 10 d. This free coinage and the freedom to melt or export the coins, combine to maintain the legal relation between the values of gold bullion and sterling. The shilling is a subsidiary token coin which is legal tender up to the limit of 40 s. Bank notes and treasury notes are full legal tender and are redeemable in gold coins and constitute accessory money.[1]

Like the above system of the gold standard or gold mono-metallism, there is the silver mono-metallism or the silver standard. The latter system prevailed in India before 1893 and in Great Britain before 1816 as it existed likewise in other European countries before they emerged into the gold standard system out of bimetallism in the latter part of the nineteenth century. This last, known as the double standard, imparts to both gold and silver the characteristics of either of the first two systems, the ratio between the values of two metals being fixed by law. What is called the 'limping' standard is either a decayed form of the preceding or may develop from the other standards; and its chief distinguishing feature is that under that system side by side with the principal standard money of gold or silver or paper, there is a full legal tender money made of the other metal which is not, however, freely coined and remains in general circulation because its face value is greater than the intrinsic value. The thalers in Germany and the silver five franc pieces in France after the two countries adopted the gold standard, occupied this position. Under the 'gold exchange' standard, already referred to above, the value of the chief legal tender money is fixed in relation to gold without there being free coinage, gold kept in a special reserve being used only to convert internal money into gold exchange to meet foreign obligations and to maintain the nominal value of the internal currency of silver or paper. Silver is coined and paper money is issued according to the requirements of internal circulation, and these are supplied by the State in exchange for gold, but the yellow metal may be made available only so far as it is needed for

1 The restoration of the gold standard in Great Britain in the middle of 1925, (it was in a state of suspension owing to war conditions) was accompanied by restrictions regarding free coinage, encashment of notes and the export of gold.

purposes of remittance abroad, exchange on gold standard countries being usually offered in the place of actual gold. The "gold bullion standard" is a system of the self-same character, and in it gold is supplied in the shape of bars but not of coins. Lastly comes the paper standard and it generally arises when paper money can not be redeemed or converted into specie and becomes the principal and the standard money. It may be easily converted into the gold exchange standard if a reserve of gold is created and the internal money is converted into gold for external payments, by the State. A good monetary standard ought to provide for sufficient currency and stable prices within a country and also for securing the convertibility of national money into gold, which is international currency, at a stable rate, and it should be automatic and smooth in its working. The adoption of the gold standard and its restoration, after temporary suspension, in post-war years by one country after another in the West, demonstrates the importance of these considerations while, of course, fixity of foreign exchange is the predominant motive underlying the gold exchange standard.

167. In Ancient Times:—The history of Indian civilization may be expected to throw light upon the various phases of the gradual rise of money economy, from the use of cattle, skins and cowries to unstamped and stamped metallic pieces as measures of value and means of payment. Though barter largely prevailed in Indian villages, gold, copper and silver coins have been very commonly used by the people from remote times. There is sufficient evidence to show that during several centuries preceding the Christian era, and of course succeeding it, emperors and kings highly cherished the privilege of coining metallic money, and the external and the internal trade of the country required coins of various denominations. The importance of metallic money was clearly understood and royal mints were systematically managed. The extent to which money was used depended upon the stage of economic progress attained by the community or locality and no uniformity can be looked for in this respect in India, in ancient or later times. The use of regular currencies could not, of course, prevail in the age of the Vedas. Pieces and lumps of gold (rukma) were used in place of coins, and in the Rig Veda there is a reference to the gold Mana, an old semitic measure or coin.[1] Values appear

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1 P. T. Shrinivas Iyenger: 'Life in Ancient India.'

to have been estimated in terms of cattle ; but a reference to Nishkas and to Dasha-hiranya-pindas in the Rig Veda suggests the use of coins and unstamped metallic currency. The Brahmanas mention other coins such as the Pada and Krishanala. The Budhist times were a period of transition. We are told that 'the older system of traffic by barter had entirely passed away never to return. The later system of a currency of standard and token coins issued and regulated by government authority had not yet arisen'. Barter was not, however, quite uncommon and articles like pieces of cloth were employed as means of payment. But there is distinct progress. Transactions were carried on, values estimated, and bargains struck in terms of the 'Kahapana', a square copper coin weighing about 146 grains, and guaranteed as to weight and fineness by punch marks made by private individuals.[1] No silver coins appear to have been used and gold coins are rare. But there is evidence in the Jatakas to show the existence of a variety of coins ; and Panini refers to several different kinds. In the centuries just preceding and succeeding the Christian era, we have silver and bronze coins, punch-marked, cast and struck on one side only.[2]

The Arthashastra of Chanakya refers to the Superintendent of the Royal Mint (Lakshnadhyaksha), and to the Examiner of Coins (Rupadarsha) whose duty it was to regulate currency both as a medium of exchange (vyavaharikim) and as legal tender (koshapraveshyam). Silver coins (rupyarupa) are made up of four parts of copper and one-sixteenth part of any of the other superior metals. Copper coins (tamrarupa) are also mentioned. Counterfeiting is visited with appropriate punishments. The Mahabharata makes mention of copper and gold coins, the latter being also used as ornaments, viz. necklaces. Silver does not, however, appear to have been used for purposes of coinage. The weights and the comparative values of coins of gold, silver and eopper are given in detail in the Smritis of Manu,[3] Narada &c. and in the Shukra Niti. 'Karshapana,' 'Nishka' and 'Suvarna' are some of the names of the coins mentioned, and Narada tells us that 'Suvarna' was

1 Rhys Davids: Budhist India.

2 Rapson: Ancoient India.

3 लोकसंव्यवहारार्थं याः संज्ञाः प्रथिता भुवि ।
ताम्ररूप्यसुवर्णानां ताः प्रवक्ष्याम्यशेषतः ॥—Manu VIII, 131.

otherwise known as 'Dinara,' the Roman 'Dinarius.' India's brisk foreign trade in the early centuries of the Christian era stimulated a flow of Roman coins into the country and the imitation of those coins by Indian rulers. It will thus be seen that the transition from barter to a money economy and to a system or systems of mints and currencies, was slowly accomplished by the early centuries of the Christian era though barter and crude coinage survived in parts of the country even to later times.

168. Pre-British Period:—The Mahomedan kings of Delhi in the Middle Ages, had their own distinctive coins, and Altamish introduced a purely Arabic coinage and made the silver 'tanka' of 175 grains, the ancestor of the rupee, his standard.[1] Mahammad Taghluk improved the gold and silver coinage and introduced a token currency of copper which, however, he had to recall on account of the ease with which it lent itself to counterfeiting. Akbar improved the currency still further and it was maintained in the time of his successors. Abul Fazl describes Akbar's rupee as 'a silver coin of a round form in weight $1\frac{1}{4}$ Mashas' and states that it was first introduced in the time of Sheer Khan and that it was revived and made more pure in his master's reign. He likewise describes gold coins like the Mohur, this coin being round in form, weighing 11 Mashas and being valued at 9 rupees. The principal copper coin was the Dam, formerly called 'Pysha' and in value the 40th part of a rupee. Gold coins were struck at four places in the Empire, in Bengal and at Agra Cabul and Ahmedabad. Silver and copper were coined at ten other cities besides, while copper alone at many more. As regards the use of the different coins, Abul Fazl significantly remarks:—"A great deal of traffic is carried on in this flourishing country in Mohurs as well as in Rupees and Dams." The danger of clipt and light-weight coins being used for defrauding the State treasury, was recognized and the weights below which coins were no longer legal tender, were decreed by government.

The Mahomedan rulers of central and southern India followed the example of the Delhi emperors and issued gold and silver coins. Under Mahratta rule the gold Hon was the standard coin and money of account, and grants were made and assessments of the land tax were fixed in terms of the gold coinage. The rupee coins of the Mahomedan

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1 See Lane Poole: Mediaeval India.

kingdoms, however, circulated widely in the seventeenth century, and the rupee soon came to have an extensive vogue. It is well known that even in very old times, the exports of India were paid for by foreign countries in gold, and Roman coins have been found in large quantities in the Madras Presidency. There is no wonder if in a large continent like India, divided into numerous kingdoms and principalities, hundreds of different coins should have been issued and been simultaneously in circulation. The coins were known by the names of the places where they were minted. The varying relative values of these coins[1] must have caused uncertainty and inconvenience in commercial transactions, but the intrinsic values of the chief coins were probably well known to experts and business men.

To mint and issue coins was an important prerogative of sovereignty and was exercised by petty rulers as much as by powerful kings. Several of the coins bore the effigies of the rulers and the distinctive names of the places where they were minted. Under the Mahrattas, in the middle of the eighteenth century, manufacturers of money were licensed by the government on payment of a fee, and the weight, quality and denomination were fixed. The ratio of the Delhi gold Mohur to the rupee was 1 to $15\frac{1}{2}$. The mints were open to private coinage in the sense in which the expression is used in Economics, and the supply must have been well adjusted to the demand. It appears that the silver rupee coin circulated very largely in northern India and the gold mohur was only a supplementary coin there. The position was reversed in southern India where the gold coin enjoyed the widest circulation and the silver coins were only subsidiary to it. As the power of the Moghals did not spread to southern India, their currency system was not adopted in those parts. The landmarks in the history of Indian currency since the beginning of the last century will be indicated below. From them it will be seen that whereas under the Hindu and Mahomedan rulers, both gold

1 "Mr. Macleod in his work on "Indian Currency" mentions that when British Rule commenced there were no less than nine hundred and ninety-four (994) different coins of gold and silver current in India. In an official table published for the guidance of the civil courts in the Bombay Presidency the names of no less than thirty-eight gold coins and over one hundred and twenty-seven silver coins are mentioned as still so far current in different parts of this Presidency as to make it worthwhile to give the relative intrinsic values of these local currencies in exchange for the Queen's coin."—Ranade: Currencies and Mints under Mahratta Rule.

and silver coins circulated freely in the country without an attempt on the part of governments to fix, from time to time, and steadily to maintain the relative legal values of the two, under British rule; the silver rupee was constituted into the principal coin of the whole country, supplemented by paper currency and later on by the gold sovereign whose relation to the silver coin was fixed by law.

169. Under East India Company :—The confusion caused by the multiplicity and variety of coins current in its territories, led the East India Company, which had its own distinctive rupees[1] coined in Bombay and Madras, to think of making the currency uniform; and though in 1806 the Directors declared that while "fully satisfied of the propriety of the silver rupee being the principal measure of value and the money of account," they did not wish "to introduce a silver currency to the exclusion of the gold," only twelve years later, the silver rupee was substituted for the gold 'pagoda' as the standard coin of the Madras Presidency, where gold coins had, till that time, been the principal currency and money of account. There had been four different rupees in circulation, those of Murshidabad, Fourrukhabad, Arkot and Surat, besides the gold Mohur and the pagoda worth respectively Rs. 15 and Rs. $3\frac{1}{3}$. The Mahratta territories also had their own rupees coined in various places. These coins, both gold and silver, were, of course, no longer issued from the mints in British India and were not, therefore, standard money. There was, therefore, no question of bimetallism, and its introduction was not contemplated. The gold coins in the hoards and in the circulation, could be treated as only so much bullion unless the government of the Company recognized them as currency having a fixed relation to its own standard money. The consolidation, under one authority, of large territory, previously governed by a number of rulers, demanded a common monetary system. Efforts were consequently made steadily to unify the currency, and they at last culminated in the demonetization of gold and the establishment of the rupee as the only legal money of the country. The history of the evolution of the present currency system is briefly given below.

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1 The first British Mint in India was established in Bombay in 1671, and the East India Company, as it extended its territorial authority, took up the indigenous rupee as the basis of its own silver currency.

(1) In 1835, the first decisive step was taken to inaugurate silver monometallism as the currency system of this country. The present silver rupee, weighing 180 grains, $\frac{11}{12}$ ths fine, was formally established as the standard coin in the whole of British India, and gold was demonetised, that is to say, was deprived of its status of the metal out of which absolute legal tender money could be made. It was enacted that 'no gold coin shall henceforward be a legal tender of payment in any of the territories of the East India Company'. But by a proclamation of 1841 Government authorised officers in charge of public treasuries freely to receive gold mohurs at fixed rates which represented a ratio of 15 to 1 between silver and gold. This operation, which resulted in the disappearance of gold coins from circulation, was not disadvantageous to the government so long as the commercial ratio between gold and silver was higher than this ratio and there was a premium on gold, but the position was reversed as soon as the ratio became favourable to silver owing to the comparative cheapness of the yellow metal. By the middle of the last century gold depreciated owing, among other causes, to the discoveries of the metal in Australian mines, and government in India became embarrassed when the public took advantage of the divergence between the legal and the market ratios of gold to silver by presenting gold at the treasuries and exchaging it for a larger value in silver. (2) A notification was, therefore, issued towards the close of 1852, declaring that on and after 1st January, 1853, "no gold coin will be received on account of payment due or in any way to be made, to the government in any public treasury within the territories of the East India Company." This was the second deliberate measure taken to fortify the silver monometallism initiated in the year 1835.

Nevertheless, the 'battle of the standards' was fought on the Indian soil as on that of Europe, and the difficulty of adjusting the ratio of gold to silver was experienced in India as elsewhere. Both gold and silver had their advocates in India, and there was a division among the officials of government. Merchants in India, Indian and European, memorialised the Government of India for a gold currency, and the latter were prepared to make sovereigns and half-sovereigns legal tender at the rate of one sovereign for 10 rupees. Officers like Sir Charles Trevelyan, Finance Member of the Government of India from 1863 to 1865 and Sir Richard Temple, a few years later, strongly sup-

ported the proposal of a gold currency linked up to the rupee at a fixed rate. The Mansfield Commission appointed to inquire into the question, likewise warmly recommended, in 1866, that gold coins should be made legal tender money. The Government in England, however, did not approve of the proposal and only authorised the receipt of gold coins in public treasuries as used to be done before 1853, at fixed rates which were slightly raised two years later.

170. Bimetallic System :—The uniform practice in almost all countries, western and eastern, has been for governments to issue from their mints, coins of both gold and silver and then to fix their relative values or leave them to be determined by economic forces. Movements in the course of trade as well as conditions under which the precious metals were produced, caused the predominance now of silver and now of gold in the circulation of national currencies. Changes in the weight and legal ratio of the coins, therefore, became necessary from time to time. England adopted gold monometallism in 1816, but the other nations continued to have legal tender coins made of gold as well as of silver. These media of exchange are, however, measures of value, and their quantity in circulation has an effect upon their purchasing power and is itself limited by that power. The regulation of a uniform supply of currency and of its steady purchasing power becomes exceedingly difficult under the bimetallic system and caused serious confusion and annoyance in the middle of the nineteenth century. Fluctuations in the relative values of gold and silver in European countries and America where currencies were on a bimetallic basis, caused great embarrassment by the influx now of one metal and now of the other. The value of silver compared with that of gold began to fall with the relative increase in the supply of the former or an augmented demand for the latter, in the third quarter of the nineteenth century, and as some European countries followed England's lead in adopting the gold standard, the other nations of Europe combined in the Latin Union to protect themselves from the danger of being overflooded with the cheap white metal. The value of silver which was 60 $\frac{5}{16}$ d. per. oz. in 1872, came down to 53$\frac{1}{8}$ d. in 1876, to 50$\frac{1}{16}$ d. in 1883, to 42$\frac{7}{8}$ d. in 1888 and to 35$\frac{1}{16}$ d. in 1893. The countries of the Latin Union were at last compelled to abandon the bimetallic system and to give up the free coinage of

silver. Thus came to be established the 'limping' standard under which though silver coins were full legal tender, there was no free coinage and they were virtually token money. This meant the triumph of the gold standard, which has now been adopted in all countries of the world except China, which also has been making an attempt to follow the other nations.

Under the system of bimetallism, as has been already stated, both gold and silver are standards of value, and the relation between the values of the two is fixed by law from time to time. Mints are open to the coinage of both the metals and both are full legal tender. The market rates of gold and silver fluctuate according to the law of demand and supply, while the lagal rates remain fixed, and for the time being, the overvalued metal drives the undervalued metal out of circulation and out of the country which temporarily comes to have a currency of only one metal. Gresham's law comes into operation, the weaker coin alone remains in circulation, the other being melted, hoarded or exported, and the supply of currency falls short of the demand. If bimetallism were adopted by the principal nations of the world, the fluctuations and the embarrassment would be considerably minimised. But no agreement could be arrived at on this question, the monetary conferences which were held in 1867, 1878, 1888 and in 1892, to settle the problem, proved infructuous and nations had to adopt the gold standard accompanied by a limited legal tender silver currency, whose parity with gold was maintained by State regulation of the supply of the white coins. Germany in 1871 and France in 1876, went over to the gold standard primarily with the view to secure a stable monetary exchange with Great Britain, the most advanced and powerful commercial and industrial country in the world. Their lead was followed by other European nations.[1]

171. Difficulties in India :—The Indian government continued to be pressed for a gold currency, particularly when gold was com-

1 "The strong man stands his ground and the weak man shifts it. England once possessed of a gold standard, is the model Power because she is the strongest......If a State with the silver standard had had the undoubted predominance of England in 1871 this State would have driven even England to follow her example, for this State would then have been the leader."—G. F. Knapp : The State Theory of Money.

paratively cheap; and at last in 1874, it definitely declared itself unable to recognize gold as a standard of value in this country. From 1835 to 1899 the Indian currency rested on a silver basis, but the circumstances which ultimately forced government to adopt the gold standard were peculiar. Its troubles were not due to bimetallism, as the Indian currency system was silver monometallism. The circumstances were these. India is a debtor country. Its government has to remit to England every year crores of rupees for meeting the Home Charges, its expenditure in London on account of interest on public debt, salaries, pensions, purchase of silver and stores and so forth. The revenue of government is collected in silver rupees and the charges in England must be met in gold. When silver was demonetised by European countries and its supplies were larger than the demand, the value of the white metal expressed in gold steadily fell. The lower the gold value of silver, the larger was the amount of rupees the government had to find to meet the Home Charges. In fact, a drop of one penny in this exchange value, added more than one crore to the amount of rupees that had to be provided for procuring the necessary amount of gold to meet the Home Charges in England.[1]

(3) Besides the government, merchants, European officers and others who had to make remittances to England, sustained a loss and had to suffer from the inconvenience of instability. The Government of India, therefore, felt the necessity of adopting the gold standard and the introduction of a gold currency, and the temporary suspension of the compulsory coinage of silver in the Indian mints, had been suggested to them; "but the main object of such attempts as were made by the Government to deal with the subject between 1878 and 1892, was not to effect a change in the standard of India

1 "To make this point clearer, it may be mentioned that in 1873-74, before the fall in the exchange value of the rupee commenced, the amount of Home remittance in lieu of payments the Secretary of State makes in England on behalf of the Indian Government, of such charges as interest on debt raised in England, civil and military pensions, salaries, the price of stores etc., was about £ 13 millions which at a rate of exchange of 1 s. 10·351 d. was represented by Rs. 14,26,57,000. During 1892-93 the amount remitted was £ 16½ millions which at the average rate of exchange in this year, viz. 1 s. 2·985 d. required a payment of Rs. 26,47,84,150. If this had been remitted at the rate of exchange of the year 1873-74 it would have needed only Rs. 17,75,19,200; which means that there was a loss of Rs. 8,72,64,950, entailed upon India by the falling exchange in that year."—Author's "Gokhale and Economic Reforms," page 28.

but to facilitate an international agreement which might cause a rise in the gold price of silver, and thus diminish the inconvenience resulting from the retention of a silver standard in India." It was in this manner that the Indian government came to be associated with and interested in the efforts of bimetallic countries to steady the ratio between the values of gold and silver, though it had no intention of changing its own silver monometallic system. The United States of America too had to face the problem of depreciating silver, especially on the pressure of the producers of that metal, and attempts were made in that country by the Bland Allison and Sherman Acts to maintain the price of the white metal by the government's continuous purchase and coinage of fixed quantities of that metal.

(4) In the meanwhile, in 1876, commercial bodies in India had begun to urge upon government the need of suspending the coinage of silver temporarily with a view to prevent the further fall of the rupee. But government did not countenance the proposal on the ground that interference with the Indian standard of value had not been called for. Only two years later, however, they made a representation to the Secretary of State pointing out the difficulties and losses entailed upon them and on the country by the fall of silver and recommending the establishment of the gold standard. But Her Majesty's Treasury was opposed to the change, and the Imperial government would not sanction it. The twenty years' period between 1873 and 1893 has been divided into three stages: (1) 1873 to 1878, when plans about the suspension of rupee coinage and the introduction of a gold currency were discussed; (2) 1878 to 1892, the year of the calling of the Brussels International Monetary Conference, during which efforts were made to secure an international bimetallic agreement and (3) 1892 to the closing of Indian mints to free coinage, when hopes relating to the restoration of bimetallism had melted away.

(5) When the rehabilitation of silver by an agreement among nations appeared to be unattainable, mainly owing to the apathy and hostility of the British government, the Government of India, whose financial position was becoming almost desperate, at last proposed in a despatch of 21 st June, 1892 at once to close their mints to the free coinage of silver and to make arrangements for the introduction of a gold standard. In a telegram to the Secretary of State, of 22 nd

January, 1893, the Government of India further explained their proposal by saying that they would issue a notification declaring that English gold coins would be legal tender in India at a rate of not less than 18d. per rupee and that an interval of time should elapse between the mints being closed and any attempt being made to coin gold in India. The hands of the government had been strengthened by a powerful agitation that was carried on in India under the auspices of the Currency Reform Association led by Mr. J. Mackay (now Lord Inchcape) in favour of currency reform on the above lines, though there was a large body of opinion in the country opposed to the proposed change.

172. Herschell Committee:—(6) The Secretary of State for India referred the proposal to a committee presided over by Lord Herschell, which examined a number of other schemes urged as remedies for the prevailing currency trouble, and reported in favour of the suggestions of the Indian government with slight modifications. The Committee recommended that though the mints were to be closed to free coinage, they were to be used for coining rupees in exchange for gold at the rate of 16d.to the rupee. and gold was to be received at the public treasuries in payment of public dues at the same rate. These provisions were intended to render the transition in the development of the currency system smooth and as free from sudden disturbance as possible. The Committee could find no alternative to the closing of the mints for freeing the Indian government from its financial difficulties. In accordance with the recommendations of the Committee, Act No. VIII of 1893 was passed providing for the closing of the Indian mints to the "free coinage" of both gold and silver, however, reserving power to government to coin rupees on its own account. By notifications arrangements were made for the receipt of gold at the Indian mints in exchange for rupees at a rate of 16 d. per rupee. When the question was raised in 1897 whether the Indian government would join France and the United States of America in following a common policy of free coinage of silver and gold at a ratio of 15½ to 1, that government recorded the decided opinion that it would be unwise to do so in view of the stability which the Indian currency and exchange system had been steadily attaining after a great deal of uncertainty and trouble.

The basic idea of the proposal to close the mints had been to raise the gold value of the rupee by stopping the increase in its

circulation so as to restrict the supply in relation to the demand.[1] As the quantity of the silver coins available for payments ceased to grow, it was thought the purchasing power of the rupee would rise. In selling rupee drafts on the Government of India to draw funds for the home charges, the Secretary of State had to face the competition of bankers and merchants, who could always remit money to this country by adopting the alternative method of exporting silver and having it coined at the mints here. The price of silver in the London market set the lower limit to the gold value of the rupee, that is to say, the exchange, and as the white metal steadily depreciated, the Indian exchange declined in sympathy. If one of the two sources of the supply of rupees was cut off by the closing of the mints, competition would disappear and the lower limit of the gold value of the rupee would rise; and if gold was imported, it would be exchanged for rupees only at a high fixed rate, which was the maximum limit of the value of the rupee. It is necessary to notice an important point here. It was always assumed that the price of silver and the rupee exchange were depressed by Germany's demonetisation of silver and the large influx of that metal into India on trade account. As a matter of fact, as was indicated in Goschen's Silver Committee report of 1876, this result was brought about chiefly by the large sales of rupees, effected through government bills by the Secretary of State, which took the place of private imports of silver. This circumstance also accounts for the steadiness of prices in India. Increased supply of government bills superceded the flow of silver to India to an appreciable extent and contributed to the fall in the price of silver.[2] By the time the Secretary of State for India appointed the Fowler Committee in 1898 to consider and report upon certain proposals which the Government of India had made with the object of making effective the policy adopted in 1893, the currency position had developed thus :—(1) gold is not legal tender in India

1 At first reliance was chiefly placed on the contraction of the rupee currency as a means to raise its value, external and internal, and the possibility of ensuring the reciprocal conversion of rupees into gold had not yet dawned upon the mind of the government, which five years later, proposed to melt down a large quantity of rupees in order to push the rate of exchange higher. It was not, however, the deflation of internal circulation so much as the dissolution of the link between the rupee and silver which brought about the realization of the object in view. See Bertrand Nogaro : *La Monnai et les Phenomens Monetaires Contemporaines.*

2 See Appendix III to Herschell Committee's Report.

though the government will receive it in the payment of public dues; (2) that the rupee remains by law the only coin in which other than small payments can be made; but (3) that the Indian government has declared (until further notice) a rate at which rupees can be purchased for gold coin or bullion—such rate serving to determine the maximum limit to which the sterling exchange can rise under present arrangements.[1]

The rate of exchange adopted on the recommendation of the Herschell Committee, had been only tentative and it was to be definitely fixed in the light of experience. Owing to the above mentioned causes, the rate of exchange had slowly mounted up. The average rate was 14·5 d. in 1893, 13·1 d. in 1894, 13·6 in 1895, 14·4 in 1896, 15.4 in 1897 and 15·9 in 1898. But uncertainty about the future still hung over trade and banking, and it was felt that the time had come for putting an end to the period of transition. The Indian government, therefore, proposed to create a gold reserve by borrowing, to withdraw from circulation and melt down rupees so as to raise the value of the rupee to 16 d. and to add to the gold reserve by the sale of bullion obtained by melting rupees, all these suggestions being designed to promote the establishment of an effective gold standard. The hands of government were, in this manner, forced and it had now to accept a policy which it had long refused to favour. Losses involved in sterling remittances and caused by the continuous fall in the gold value of silver and of the silver rupee, were the determining factor in the currency and exchange situation. Widely divergent opinons were held as to the wisdom and the justice of the policy adopted in 1893, and the several interests concerned, looked at the question from different points of view. The British Treasury, to whom such questions were, as a rule, referred by the Secretary of State on the receipt of proposals from the Indian government, consistently set its face, in 1879 and in 1886, against tampering with the India currency and making it artificial. It was pointed out that whatever relief would be secured by government as a result of such measures, would be at the expense of the Indian taxpayer. This attitude deserves to be noted in view of the later controversies relating to a change of ratio to a higher level. Exporters of Indian

1 Report of the Fowler Committee.

produce like the tea planters were opposed to the change, while importers of foreign goods supported it as they would benefit by it. Public opinion in India had been opposed to the policy of 1893 ; and all interference with the country's currency had been deprecated as unnecessary and harmful.

173. Fowler Committee:—(7) The problem of Indian currency and exchange had been debated for nearly forty years; nor is it regarded as solved even now. But in 1898 government had to make up its mind as to what system it would finally adopt. On the one hand, (1) the need of stability of exchange as a condition of smooth and prosperous trade, (2) the necessity of preventing the losses which a falling rupee entailed on government, and (3) the utility of establishing the same standard as prevailed in England and other countries with which India's trade chiefly lay, were urged in favour of the adoption of a gold standard and in justification of the closing of mints to the free coinage of silver. It was pointed out, on the other hand, (1) that silver monometallism was the best policy for India as it had worked satisfactorily on the whole, and prices had remained steady under it, (2) that government's exchange difficulty could be met by retrenchment and economy and the systematic curtailment of India's gold obligations e. g. home charges, (3) that a falling exchange had stimulated trade and promoted prosperity and (4) that an artificial currency system was undesirable, especially because it meant the transference of the loss of the administration indirectly to the shoulders of the people.

All these conflicting views were placed by witnesses before the Fowler Committee which had to decide whether India should revert to the old system or follow up the arrangements initiated in 1893, as well as to examine the Indian government's scheme and to recommend a satisfactory method of stabilizing the exchange value of the rupee. On a review of the whole position and a careful consideration of the divergent opinions submitted to it, the Committee declared itself unequivocally in favour of the effective establishment of a gold standard to be accompanied, of course, by a gold currency,[1] the British sovereign being declared a legal tender

1 "Looking forward as we do to the effective establishment in India of a gold standard and currency based on the principles of free inflow and outflow of gold, we recommend these measures for adoption."—*Report of the Fowler Committee*,

along with the rupee at the rate of 1 sovereign = 15 rupees. The Indian mints were "to be thrown open to the unrestricted coinage of gold on terms and conditions such as govern the three Australian branches of the Royal Mint." The restrictive legislation of 1893 and other causes had pushed up the gold price of the rupee and, therefore, the exchange to 16 d., a rate at which the Committee stated that it should be finally and legally fixed. The rupee now became a token coin as its face value would be higher than its value as silver metal, but the Committee could not recommend the imposition of a limit on the amount for which rupees should constitute a legal tender.[1] Token coins are usually subsidiary coins and *vice versa*, but their legal tender character need not necessarily be restricted to a particular amount. The profit on the coinage of rupees, which was to be undertaken when the proportion of gold in the currency exceeded the demand, was to be accumulated in a special reserve fund. This profit would represent the difference between the intrinsic metallic value of the rupee and its artificial value. These recommendations were accepted in their entirety by the Indian authorities, and steps were immediately taken to carry them out. It is necessary to realize that the Fowler Committee's complete scheme not only provided that the gold standard of India should be a quantity of gold equivalent to one-fifteenth part of a sovereign, that is, about 7⅓ grains of the yellow metal but contemplated that this equivalence of the rupee, the Indian unit of value, in gold, should be maintained by means of a free gold mint, reciprocal convertibility of internal currency and gold coins and the automatic expansion and contraction of monetary circulation within the country. As gold currency was to be the regulator of values, this may be characterized as the "gold currency" standard as distinguished from the "gold exchange" and "gold bullion" standards.

The Fowler Committee, of course, rejected the Government of India's proposal regarding the melting of rupees and constituting a gold reserve out of borrowings. But the most important schemes submitted to it were the Lindsay and Probyn schemes which have special interest, in particular, the proposals of Mr. Lindsay, because

1 "Under an effective gold standard, rupees would be token coins, subsidiary to the sovereign. But existing conditions in India do not warrant the imposition of a limit on the amount for which they should constitute a legal tender; indeed, for some time to come, no such limitation can be contemplated."—Report.

they formed the basis and the inspiration for the gold exchange standard which was ultimately evolved out of the Fowler Committee's recommendations in favour of a gold standard accompanied by a gold currency. The essence of the Lindsay plan was the constitution of a gold reserve fund to be located in gold in London and another to be held in rupees in India out of which drafts, to be sold either way by government, were to be met. The drafts were to be offered at rates just below and above the gold import and export points to obviate the remittance of gold to and from India. As government rates would be cheaper, the trade would not care to make actual remittances of gold either way; and exchange could thus be stabilised by the action of government. Gold was to be used, under this system, not for internal currency but only for settling India's balance of foreign indebtedness when necessary. The plan proposed by Mr. Lesley Probyn was also intended to do away with the necessity of a gold currency. He would issue a gold note of Rs. 10,000 denomination and keep the gold reserve in India. The gold was not to be coined but was to remain in the form of bars.[1] The Fowler Committee approved of neither scheme and held that "the habit of hoarding does not present such practical difficulties as to justify a permanent refusal to allow India to possess the normal accompaniment of a gold standard, namely, a gold currency."

174. Opposition to Change of Standard:—It may be generally observed that, in view of the serious lapses committed in this matter in later years, the currency policy recommended by the Fowler Committee has been admitted, on the whole, to have been a sound policy, though the steps which led to it were partly the result of a panic, partly of helpless drifting and partly of concentration of attention only on one aspect of the problem viz. government's financial embarrassment caused by a falling exchange and the loss incurred by those who had to make remittances abroad. It is interesting to recall the strong views expressed by financial experts and high government officials before 1893 against any tampering with the Indian silver standard. These opinions have a special value on account of the source from which they proceeded, and can not be discounted as the idle and ignorant effusions of the ultra nationalism of Indian critics.

1 This scheme is specially interesting in view of the principle underlying it having been adopted by the Hilton Young Commission as the basis of the 'gold bullion standard' proposed by it and approved by the Indian government.

Mr. R. Hardy, Treasurer and Secretary, Bank of Bengal, stated in a memorandum, dated 22nd May, 1886:—"In conclusion, I would observe that the whole position of India, as a nation, in regard to the silver question, may be stated broadly as follows:— The foreign trade of India consists of exports of merchandise: the exports pay not only for India's gold obligations abroad, but for her imports of merchandise as well, and a balance always remains in her favour. This balance she takes in silver. If silver is cheap she gets more of the metal than she would get if it were not so cheap, and I hold that it is most to her advantage to get more than less silver. It, moreover, appears obvious that the pressure of the gold payments upon India as a whole, depends not upon the price of silver, but upon the gold prices realised for the merchandise exported to meet such gold payments. That the Government is in the position of receiving its revenue in silver, it may be asserted, does not affect that, the national aspect of the question, and in my view it is therefore, clearly the duty of Government to meet any financial necessity arising from a fall in the exchange, either by increasing taxation or by reducing expenditure, or by both. To attempt to meet the difficulty by taking the extreme measure of changing the standard of value is, I think, out of the question, and I express this view, holding the opinion that the value of silver will probably yet fall considerably."[1]

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1 See Selection from Papers relating to the Introduction of a Gold Currency in India, pages 433 to 460. Referring to Lieutenant-General Strachey's proposal to give India a gold standard without a gold coinage, provision being made for the expansion of the currency to meet requirements of trade, Mr. J. Westland, Controller and Auditor General, and afterwards Finance Member, Government of India, wrote in 1886:—"I am inclined rather to say that greater facility in meeting its home obligations is the *only* interest that India has in a gold standard; and if a silver standard is better with respect to all its other relations and concerns, I can not concede that the question connected with its home obligations is of such tremendous importance as to overwhelm all others. The fact that our European officials, regarding our connection with India as only temporary, look to the gold standard of the country, where we ultimately intend to live as preferable, for our own purposes, to the silver standard of the country where we earn our living, is somewhat apt to increase in our eyes the importance of remittance from India to England. But if we want to stay in India all our lives, and our children after us, as the definite majority of people dwelling in India do, I doubt if we would look upon a manifestly appreciating standard as more desirable than one which has been fairly steady in the past, so far as absolute value can be measured......"

This was broadly the national point of view urged in favour of the maintenance of the *status quo*; and the interests of the people of India on the one hand and those of the government and Europeans on the other, came to be placed in glaring opposition. There was a large body of people in India holding similar opinions.[1] And they contended that (1) the exchange difficulty could have been and ought to have been met by economy and a reduction in the gold obligations of government; (2) it was not necessary to alter the standard of value as an artificial increase in the value of the rupee was only another method of imposing additional taxation upon the people in an indirect way; (3) that there was no room for the reduction of expenditure was not believed by the public which was pressing for economy and for justice being done to India in the matter of financial burdens; (4) the plea that the limits of taxation had been reached was not also accepted as government was not prepared to impose import duties on British piece goods for fear of Lancashire opposition.[2] The argument that a falling and low exchange stimulated exports and promoted India's prosperity, ought not indeed to be carried too far because a country soon adjusts itself to a low rate and exchange can not go on falling indefinitely. But as Prof. Kemmerer concludes, 'the actual development of the merchandise import and export trade, therefore, during the twenty years prior to the Herschell Committee's Report, had hardly been such as to justify a strong condemnation of the silver standard.'[3] And for years, the gold prices of India's chief imports had been declining more rapidly than the gold value of the rupee, and India had been actually receiving from Europe larger quantities of these goods on the average per rupee.

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1 See Appendices to the Report of the Fowler Committee, pages 47 to 65.

2 Mr. D. Barbour, Secretary to the Government of India, Department of Finance and Commerce, and later, also Finance Member in the Government of India, held identical views and maintained :—" The loss or gain therefore to India, as distinguished from the Government of India, in respect of her permanent gold obligations, depends entirely on the gold prices which she can obtain for her exports. No manipulation of the Indian currency can possibly affect the gold prices of Indian exports and therefore General Strachey's proposal could in no case give any relief to India as a country whatever effect it might have on the financial position of Government. Just as much as Government gained, just so much must the Indian people lose."

3 Modern Currency Reforms, page 28.

175. From Gold to Gold Exchange:—(8) The financial embarrassments of government, the inconvenience and loss suffered by non-official and official Europeans and the ease with which the deficit of the national exchequer could be made good by taking money from the pockets of Indian producers and exporters, however, proved irresistible arguments in favour of the adoption of the suggestion to make the rupees token coins and by controlling their supply, to raise their exchange value to 16d. per rupee. Five years' experience of the steadily rising rupee and the growing conviction that it could be successfully fixed in the neighbourhood of 16 d., appeared to justify the wisdom of the policy initiated in 1893 and to weaken the force of the objections which had been raised against it. In 1899, the government, therefore, gave up its attitude of hesitancy and boldly embarked upon a policy of a gold standard to be ultimately accompanied by a gold currency. (1) Sovereigns and half-sovereigns were made legal tender; (2) active steps were taken to open a mint for the coinage of gold in India, though the scheme was dropped in 1902, to be revived only ten years later; (3) profits on the coinage of rupees were being accumulated in a special gold reserve to be used for the support of exchange; and (4) efforts were made to induce people to use sovereigns as a medium of circulation. What was tentatively adopted in 1893, was now finally accepted as a fundamental principle of the Indian currency system, and the first steps towards the goal of a gold standard and a gold currency,[1] were deliberately and firmly taken. But very soon government policy began to drift, the ideal recommended by the Fowler Committee was put out of sight, and India came to have a gold exchange standard instead of a genuine gold standard! And all this while, Great Britain and other Western nations continued to possess the full-fledged gold currency standard.

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1 It is indeed not essential for the gold standard that there should be a gold currency in active circulation, but it does require that mints should be open to the free coinage of gold alone and that the convertibility of gold coins into other money should not be obligatory while the convertibility of the latter into gold, should be ensured. In a minute quoted by the Fowler Commission, Sir David Barbour supported the introduction of the gold standard in India and referred to the example of France and other countries, as showing that it is possible to have a gold standard, though a large percentage of the circulation consists of overvalued silver coins, which are legal tender to any amount. He proposed the limitation of the number of silver coins and the provision for their conversion into gold coins.

Government (1) started with abandoning the silver standard by closing the mints to the free coinage of rupess with the view to raise the sterling value of the rupee, and for six years the Indian currency system was without any standard. (2) When success had been achieved in raising the exchange value of the rupee, government initiated (what was all along at the back of its mind) the gold standard with all the will in the world to make it effective. (3) But it was soon discovered that it was possible to keep the rupee permanently linked to gold only by ensuring the convertibility into sterling of that portion of rupee circulation which had to be remitted abroad for foreign payments, by the maintenance of a gold reserve. The prevailing idea about the close of the last century and the first few years of this, obviously was to alter the guage of the Indian currency system and to link it up to the gold standard systems of other countries with which India's foreign trade was mainly connected. The break of guage involved in India's having a silver standard, it was believed, hampered trade and caused a great deal of inconvenience to this country as well as to others. India was, therefore, to develop a gold standard system like the one prevailing in England and imitated elsewhere. The legislation of 1899 and the measures taken in consequence of its underlying motive, were admittedly intended to carry out the object stated above.

(9) "But government departed in several important particulars from the lines of policy laid down by the Fowler Committee. The investment of the Gold Standard Reserve in securities in London, the dropping of the scheme for a gold mint in India, the practice of selling Council drafts at something below gold point against the Currency Reserve, the establishment of the silver branch of the Gold Standard Reserve, the diversion in 1907 of money from that Reserve for capital expenditure and its use in 1908 for meeting drafts sold by government in India on London to private traders, are all examples of divergence from the scheme adumbrated by the Committee. The system actually in operation in 1913 had accordingly never been deliberately adopted as a consistent whole, nor do the authorities themselves appear always to have had a clear notion of the final object to be attained. To a great extent this system is the result of a series of experiments."[1] Those connected with and interested in

1 See Chamberlain Commission's Report, page 13.

the management of the currency and exchange system of India seemed to argue to themselves: "What is, after all, a successful currency system? That which ensures a stable exchange value of the internal currency viz. the rupee. Other things are of subsidiary importance, and discussion about gold in circulation, a gold mint, the gold reserve, issue of rupees and so forth, is merely of academic interest."

176. Gold Exchange Standard:—(10) The goal of a gold standard, accompanied by a gold currency, recommended by the Fowler Committee and accepted by the Indian government, grew dimmer and dimmer from the view of the authorities who managed the Indian system; and in a few years they made the pleasing discovery that they had, unconsciously as it were, established in this country a scientifically perfect and practically faultless system of currency and exchange, rightly or wrongly called the 'gold exchange standard.' Under that system, gold is the nominal standard of value, and though gold coins, viz. the sovereigns are legal tender, they do not form an essential feature of the system.[1] The principal currency is the token silver rupee which is unlimited legal tender and which there is no obligation on the part of the State to redeem in the standard metal viz. gold. The relation of the rupee to gold is fixed independently of its intrinsic worth as silver, and the coin is just a note printed on a disc of silver but not legally redeemable in gold. Currency notes are encashable only in token rupees. The obligation of government is restricted to giving token rupees for gold at the statutory rate so as to fix the upper limit of exchange and to provide gold or rather sterling drafts only when the exchange value of the rupee, artificially fixed at a high level, goes below the gold export point thus limiting the minimum value of the internal money. The gold standard reserve located in London is the fund built out of profits on rupee coinage, arising from the difference between its face and metallic values, and is the fund out of which the sterling drafts sold to the public are paid. Gold, not in circulation or open to free coinage but for use in effecting necessary foreign exchange is the standard of value and therefore the system is called the system of the "gold exchange standard."

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1 Compare the Lindsay scheme referred to above.

Several eminent economists like Professors[1] Keynes and Spalding and high Indian officials regard the exchange standard as a perfect system of currency, and the Indian discovery of a cheap and efficient system has been imitated in such countries as the Philippines, Straits Settlements, Porto Rico, Argentine and Mexico; it was tried for a time in Austria, and it is stated that the system prevails in practice, if not in theory, in countries like Japan. The exchange standard system, it is said, economises gold by dispensing with its use for internal circulation and by satisfying currency needs with silver and paper money based upon gold which becomes international currency and which is made available when required for remittance abroad. In gold standard countries like England, it is urged, gold coins form but an infinitesimal part of the money in circulation which consists of cheques and notes. The Indian system is, therefore, described as 'an improved gold standard' which will come more and more into favour as its utility is better appreciated; and in fact, it is regarded as an ideal currency system for nations to adopt. The Chamberlain Commission of 1913, which was appointed to examine and report upon the many severe criticisms which had been heaped upon the policy into which the Indian government had drifted, had nothing but commendation for the exchange standard system as it had come to be evolved in India. It summed up its view thus:—"Our view is that India neither demands nor requires gold coins to any considerable extent for purposes of circulation (as opposed to saving or hoarding), that the most generally suitable media of internal circulation in India are at present rupees and notes, and that the government should, as opportunity may offer, encourage notes, while providing—and this is the cardinal feature of the whole system—absolute security for the convertibility into sterling of so much of the internal currency as may at any moment be required for the settlement of India's external obligations."[2]

177. Criticism :—The above view of the supporters of the exchange standard would strike one as theoretically sound and practically reasonable. It will be generally agreed that economy of the

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1 See also G. F. Knapp: *State Theory of Money* and Bertrand Nogaro: *La Monnaie.*

2 Chamberlain Commission's Report, page 20.

precious metals, chiefly on account of the inadequate supply of gold, is a desirable thing and that the waste of the yellow metal, involved in the circulation of gold coins, ought to be prevented as far as practicable. But we can not endorse the statement that the exchange standard is an ideal standard that can be adopted with advantage in all conditions; and it is objectionable particularly when it is imposed on a country not by the force of economic and social developments but by external pressure and authority. It is some comfort to note that the Hilton Young Commission has exposed the defects of the exchange standard in no uncertain terms though it has not favoured the full gold standard. A country's currency must be legally convertible into the standard metal; otherwise it loses one of its essential characteristics. The exchange standard is unautomatic; and though it provides for the expansion and contraction of currency according to public needs, these operations are not satifactorily performed. Under that standard there is always the risk of too much fiduciary and token currency being issued and the provision for its conversion into gold for foreign payments proving inadequate. It is well suited to the conditions of a country which can not command an adequate supply of gold and has an adverse trade balance. It is not correct to say, without taking all circumstances into account, that the Indian currency system, based upon the exchange standard has worked more satisfactorily than the gold standard and stood the shock and stress of the last war better than the gold standard in other countries. As we shall presently show, that standard hopelessly broke down in spite of desperate efforts to bolster it up. These last entailed heavy losses upon the country and threw into glaring relief the dangers of a 'managed' currency system. In his masterly note of dissent appended to the Chamberlain Commission's report, Sir James Begbie has disposed of the objections taken to the adoption in India of a true gold standard, accompanied by gold coins in circulation, as was recommended by the Fowler Committee. The Hilton Young Commission also has shown why in the peculiar conditions of India—illiteracy, absence of the banking habit and so forth—the public must be able to see and feel the actual connection between silver and paper money and gold.

Financiers and others interested in trade and industries in other countries are alarmed at the large alleged absorption of gold in India and would like that the stream of the yellow metal flowing to this

country should be blocked, restricted and diverted into other channels. And they have received support at the hands of economic theorists. Imports of gold into India are, however, only the price paid by foreign nations for a part of Indian exports, and the currency system of India can not be developed to suit their convenience and interests though this country is obviously interested in the financial rehabilitation, stability and progress of the world. There was a time in the first decade of this century, when the supplies of gold were large and prices rose high in the West and when Indian absorption of that metal was a relief to European bankers and industrialists. But the position having been radically altered by the War, they have now been singing a different tune. A return to the gold standard which appeared at one time to be hopeless in many countries, has been slowly and laboriously brought about in most of them, and the gold exchange standard was generally regarded, where it was unavoidable, as a transitional stage and jumping off ground before the full gold standard was reached again. Monetary theory and practice have indeed travelled a great deal since John Stuart Mill expressed the view that money is a commodity like other commodities. National monies, though founded on gold, find a narrow metallic basis quite adequate, and currencies actually in use consist, for the most part, of paper, gold being kept in a central reserve for the liquidation of the balance of foreign trade. If nations could come to an agreement, it is not theoretically impossible to substitute an international paper money for gold and relegate the yellow metal entirely to purposes of art. But even the most zealous theorists and makers of monetary schemes, recognize that practical considerations require a gold basis for national currencies. Monetary practice has come into accord with economic theory owing to dire necessity and not to reasoned conviction. The enormous issues of paper money, which were practically inconvertible, and the huge national debts of the countries of the European continent, proved serious obstacles to the restoration of the gold standard. The U. S. A. has to-day hundreds of crores worth of gold lying idle with it and is releasing it in small quantities for the benefit of Europe. Economy in the use of gold is, therefore, one of the remedies suggested for the present evil, and international co-operation is preached in that regard. The Genoa Conference, for instance, suggested the concentration of the world's international money in 'gold centres' and the introduction of what was, in effect, something not unlike the exchange standard in the countries joining the

scheme.[1] But it is possible that the fears entertained about the paucity of gold for the use of the world's currency systems may turn out to be exaggerated and that nations will settle down to a gold standard as before the War. It is not wise, in the circumstances, to stampede India into the adoption of fancy monetary standards. The following figures show the world production of gold and India's net imports of that metal for a series of years :—

(A)

World's gold Production.

(In millions of £ at 84 s. 11½ d. per fine ounce).

1915	... ... 96·3	1921	... ... 67·8
1916	... ... 93·3	1922	... ... 66·5
1917	... ... 86·6	1923	... ... 76·9
1918	... ... 78·5	1924	... ... 81·8
1919	... ... 74·5	1925	... ... 82·9
1920	... ... 68·6	1926	... ... 82·9
1927	... 81·8.		

(B)

India's net gold Imports.

(In crores of Rupees)

1900–01 to 1904–05	6·2
1905–06 to 1909–10	11·7
1910–11 to 1914–15	25·3
1915–16 to 1919–20	13·4
1920–21 to 1924–25	28·7
1925–26	34·8
1926–27	19·4
1927–28	18·1
1928–29	21·1

1 "Thus the task may seem to involve great difficulties. But if we are not prepared to abolish at once and for ever the use of gold as a standard of value, we clearly must do something to stabilise the value of gold, and this is certainly not possible without a rational regulation of the monetary demand for gold. In addition, we may perhaps apply other means viz. first, suitable restrictions of the industrial demand for gold; and second, a policy aiming at checking the demand for gold from the Far East by developing Asia's needs for more useful European products."—Gustave Cassel.

178. Indian Conditions:—The alleged large hoards of gold in India, the exaggerated view taken of the heavy imports of the yellow metal into the country and the adverse criticism of the hoarding habits of the people, have been referred to in a preceding chapter. The fact that western countries also are not free from the habit of hoarding was brought out by the quantities of sovereigns and other gold coins which emerged from unexpected quarters for investment in war loans[1] and may be seen from the growing use of gold in the arts. The point is that the position in India should neither be exaggerated nor minimised. It is stated that the people here do not want a gold currency for circulation and therefore as money, and that if it is pressed on them, the coin will either be hoarded or melted for jewellery. The net gold imports of India are about one-sixth of the total world production of the metal. But it should not be forgotten that this quantity is intended to satisfy the needs of thirty-one crores of human beings and that the Indian population bears the same ratio to the total world population. It is besides doubtful if the exchange or the bullion standard is an efficacious remedy for the alleged hoarding by the Indian people.

Gold and silver have been preferred by mankind for the material of their currencies for certain rare qualities they possess, and gold in particular, has a certain fascination for man. That the precious metals are used both in arts and for currency purposes, is perhaps unfortunate in view of their limited supply. And we support the gold standard in opposition to the exchange or the bullion standard for practical reasons and not because of mere sentiment or the glamour of gold. The use of paper money must admittedly be encouraged as a more economical instrument of exchange, but in India it has its limits. If there is no sufficient gold to go round in the countries of the world and if a disastrous fall of prices is apprehended as a result of the universal use of gold for currency purposes,—assumptions not warranted by experience—they must devise some suitable system by agreement among themselves and adopt bimetallism, for instance. But India can not be expected to work a novel and artificial system which its people can not understand and appreciate and to be satisfied with an exchange

1 Committees of patriotic people in England, during war time, succeeded in unearthing small and scattered treasures of sovereigns from villages.

standard because it is inconvenient to other nations to allow her to have the gold standard and because the exchange standard is acceptable to the Philippines and the Straits Settlements or to certain European nations in their present financial embarrassment. We agree with Prof. Nicholson in thinking that it is an inferior standard which suffers from serious drawbacks and, in fact, is not a standard at all.[1]

Conditions in India in this respect are different from those prevalent in other countries which have a gold exchange standard. (1) Here the annual gold absorption is bound to continue on the present scale, for years, and the production of the yellow metal in Indian mines is four to five crores a year. (2) The balance of trade is normally favourable to this country, and fully covers the payments which we have to make in England ; and occasions when gold may be required for foreign remittance, are rare. (3) India is a debtor country, but her annual credits represented by excess exports, are not inadequate to the demand for payments abroad. (4) The accumulation with the public of token rupee coins turned out of the Indian mints and absorbed by the people, is dangerous, and if facilities are given for the circulation of gold coins by means of a gold mint and otherwise, stability of exchange will be still further secured. (5) The absence of a gold mint in India and the large circulation of silver tokens for which government does not bind itself to give gold coins, are calculated to foster the hoarding habit which every one is anxious to discourage. (6) Sufficient attention has not been paid in India, in the management of foreign exchange, to the economic interests of the country as a whole and these have been subordinated to other considerations. The immediate interests of the State treasury, of the London money market and of those making remittances abroad, have exercised the greatest influence. (7) The rupee, which is the principal coin of the country, is only a note printed on silver and its convertibility is limited. And consequently it does not inspire in the public mind the same confidence that a gold coin is calculated to do. (8) Gold coins largely circulated in India and were popular before the yellow metal was demonetised in the last century, and if the people want gold coins, there is no reason why

1 See an article on the subject in *The Economic Journal*, June, 1914 by Prof. J. S. Nicholson.

they should not be supplied to them. (9) Sentiment and public confidence contribute not a little to the success of a currency system; and it can not be said that the Indian currency is regarded as satisfactory by the public and conduces to economic progress. (10) The blundering management of the government-controlled currency system has left an unfavourable impression on the public mind, and nothing but an automatic system will meet with approval. (11) Some of the latter considerations apply to the gold bullion standard also, as will be shown later on.

179. A Gold Mint for India:—After the Fowler Committee had recommended the adoption of a gold standard and a gold currency, the Government of India took up seriously the question of starting a gold mint in Bombay, and in his financial statement in 1900, Sir Clinton Dawkins announced that every thing was ready for it. But all possible imaginary difficulties having been raised by the Mint authorities in London and the British Treasury, the project was abandoned. The enthusiasm of the government for the policy recommended by the Fowler Committee steadily cooled down. The efforts to put gold into circulation were half-hearted; and as soon as the stability of exchange at a high level was attained, everything else which contributes to the soundness of a currency system, was forgotten. But public dissatsifaction with the developments during the first decade of this century grew with the self-complacency of the Government. The question of the gold mint was raised again in 1912 by Sir Vithaldas Thackersay by moving a resolution in the Supreme Legislative Council, and Mr. Gokhale accorded his support to the suggestion that gold should be coined in the Indian mints. The Government of India sent a despatch to the Secretary of State, dated 16th May, 1912, and strongly urged the necessity of minting a gold coin in India. The plea put forward in the despatch is sup-

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1 Special enquiries were made before the War with regard to the circulation and popularity of the sovereign in the different parts of India, and Mr. Howard, Controller of Currency, arrived at the following conclusion:—"On the whole it may perhaps be fairly concluded from this evidence that the popularity of the sovereign as a medium of ordinary currency depends largely upon the extent to which it is made available to the cultivator by the various firms and middlemen who buy up his produce, and that when it is available in large quantities it is gladly accepted and used in every day transactions......There is no doubt that some gold is hoarded or, in other words, put aside to meet expenditure, but this is only natural." —Report of the Controller of Currency for 1913-14, Appendix.

ported by sound reasoning, and it completely demolishes the case of the opponents of the proposal. The despatch examines and refutes the arguments (1) that an Indian gold coin is unnecessary, (2) that it will not assist the maintenance of exchange, and (3) that it will be too expensive; by pointing out (4) that a Mint would attract uncoined gold from the hoards, thus helping to support exchange; and ends by remarking (5) that the proposal for a gold coinage had behind it the support of Indian public opinion.

Lord Crewe, the Secretary of State for India, referred the proposal to the Lord Commissioners of the Treasury. They did not accept it, and instead, offered two alternative courses:—(1) "That a branch Mint be established at Bombay solely for coinage of gold under the supervision of the Royal Mint and His Majesty's Treasury; (2) that the control of the whole of the existing Mint at Bombay be taken over by His Majesty's Government, who would accept at the expense of India the responsibility for an establishment, producing not only British gold coins but also coins for circulation in India, that is, silver and nickel." These proposals could not be agreed to; but as Lord Crewe pointed out in his reply, it was open to the Government of India "to produce at one of the Indian Mints a separate Indian gold coin of the denomination of say Rs. 10." The Secretary of State suggested that this course would be inexpensive and would avoid the intervention of the British authorities in India's general coinage operations. There was further this advantage that a gold coin of the denomination suggested would satisfy such currency requirements as are not met by the present facilities for obtaining sovereigns, rupees and notes. The Chamberlain Commission, however, holding as it did that a gold exchange standard with an actual currency consisting of token coins and notes, was quite enough for India, did not see its way to lend its support to the idea of a gold mint or even of the circulation of gold as currency. But if Indian sentiment wanted a mint and if the government was prepared to incur the expense, the Commission stated, it might have a gold mint provided the coin to be minted was the sovereign (or the half-sovereign).

The monetary stringency caused by the war, for the time being, swept away all objections and forced the hands of the government, and a Royal Proclamation was issued on 21st December, 1917, directing that a branch of the Royal Mint be established in Bombay, the gold

coin of the same denominations, designs, weights and fineness as gold coins coined at that Mint may be coined at the Bombay branch mint, that the Manager of the Mint prepare and transmit dyes for the gold coins to be coined in Bombay, that the coins so coined be deemed to have been issued from the London Mint and be legal tender in like manner and to like extent, and that the Bombay Mint be regarded, for the purpose of gold coinage, as part of the London Mint. But this measure, taken to meet a temporary difficulty and to increase the volume of currency in circulation, had soon to be suspended after about 21 lakhs of mohurs and 1¼ million sovereigns had been coined. The Hilton Young Commission finally turned down the proposal of a gold mint and recommended the demonetization of gold.

180. Gold Standard Reserve Fund:—One of the chief buttresses of the Indian currency system was the Gold Standard Reserve Fund which was created on the recommendation of the Fowler Committee and was to be formed out of the profits of the coinage of rupees. The gold thus accumulated, was to be made available for foreign remittances whenever the exchange fell below specie point. But the intention of the recommendation and the object of the Reserve were differently interpreted, and the soundness of the policy pursued by government in connection with the Reserve was seriously called in question. The chief questions for consideration regarding the Reserve were :—(1) the purpose for which it should be used ; (2) the form in which it should be held, that is, actual gold or securities or partly even in silver ; (3) its location, that is, whether it should be held in England or in India ; and (4) its amount, that is, whether it should be allowed to accumulate indefinitely and, if, not, what limit should be placed on its accumulation.[1]

These questions were forced upon public attention by the experiments which were made by successive Finance Members with the gold reserve. Sir Edward Law perpetrated the first blunder by investing the reserve in England instead of keeping it in India. He was obsessed by the possibilities of interest, with the result that

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1 See Appendices to the interim Report of the Chamberlain Commission, page 87.

India had not only lost all the advantages of a liquid gold reserve but suffered by the loss of nearly a million sterling through the depreciation of securities. Another point of departure was that in connection with the purchases of silver for his coinage operations, Sir Edward Baker decided to hold six crores of rupees on behalf of the Gold Standard Reserve in the shape of coined rupees. Then came the intervention of the Mackay committee. "The demand for railway construction had outstripped the capacity of the Government of India to furnish the necessary funds. A committee which sat in England under the chairmanship of Sir James Mackay (Lord Inchcape), light-heartedly recommended that half the profits on coinage should be diverted to capital expenditure on railways. A million sterling was misappropriated to this purpose before the universal condemnation of such a perversion of sound principle compelled the Secretary of State to withdraw a decision which in no conceivable circumstances should have been taken." Attempts were likewise made to fix a limit to the accumulation of the gold reserve fund so that additions to it beyond the limit might be devoted to capital expenditure, and £25 million was, at one time, regarded as a safe limit.

The first severe test to which the new currency system was subjected was the crisis of 1907–08 when the balance of trade turned against India. Exports fell off owing to the unfavourable character of the agricultural season and imports continued to pour in. There was consequently a heavy demand for remittance of gold abroad, and it was stimulated by the premium upon the yellow metal caused by an American financial crisis coming on the top of a scarcity in this country. The Government of India first hesitated and doled out gold in small quantities. But its stock of the yellow metal was small and was likely to be soon exhausted. It, therefore, sold sterling drafts on London to the extent of £ 8 millions, which put a severe strain on the gold standard and currency reserves in London. This experience was calculated to teach a valuable lesson in the management of Indian currency, and similar different measures were resorted to when there was an adverse balance of trade soon after the out-break of the war and in the midst of disturbed conditions resulting from it. One important effect of the crisis was to lend support to the claim that the gold exchange standard could be successfully worked even under adverse conditions provided

govornment possessed sufficient gold assets in its reserves in London to liquidate an unfavourable trade balance.[1]

181. The Commission's Suggestions:—The Chamberlain Commission, which reported in 1913, was called upon to discuss all the points in dispute between government and its critics. The Secretary of State's sales of council drafts beyond his normal needs, the huge balances he had accumulated, the large circulation of the rupee currency and the constitution and the location of the Reserves were among the leading question which were investigated. In fact, the wisdom and the beneficence of the whole currency and exchange system in India had been called in question and the scope of the investigation had to be comprehensive. With reference to the Gold Reserve, the points for inquiry related mainly to the questions whether the bulk of the Reserve should not be held in gold instead of in securities and in India instead of in London and whether the Reserve should not be used to relieve monetary stringency in this country instead of being locked up in England. The Commission thought that as the chief purpose of the Reserve was the maintenance of exchange and as the gold was wanted for payment in London, that financial centre was the proper place where it should be located. It concluded:—(1) No limit can at present be fixed to the amount up to which the Gold Standard Reserve should be accumulated; (2) the profits on coinage of rupees should, for the present, continue to be credited exclusively to the Reserve; (3) a much larger proportion of the Reserve should be held in actual gold. By an exchange of assets between this Reserve and the Paper Currency Reserve, a total of about 10,000,000*l* in gold can be at once secured. This total should be raised, as opportunity offers, to 15,000,000*l*, and thereafter the authorities should aim at keeping one half of the total reserve in actual gold; (4) the Indian branch of the Reserve in which rupees are now held should be abolished, the rupees being handed over to the Paper Currency Reserve in exchange for gold; (5) the proper place for the location of the whole of the Reserve is London; and (6) the government should definitely undertake to sell bills in India on London at the rate of 1 *s.* $3\frac{29}{32}$ *d.* per rupee whenever called upon to

1 "These measures worked well in the crisis of 1907-08, the only occasion upon which they have been severely tested hitherto."—Chamberlain Commission's Report.

do so. The consideration that a reserve of gold held in India will inspire confidence in the public mind and may be lent to Indian banks to the benefit of commerce and industries, as also the consideration that in a time of crisis, location of Indian gold in London may cause serious inconvenience and loss, did not impress the Commission, which attempted logically to deduce its conclusions from the exchange standard principle underlying the administration of the Indian system of currency and exchange; and it endorsed the view held and supported the policy pursued by government with regard to the location of the Reserve. On the outbreak of the war, the silver branch of the Reserve was abolished and a loan was taken from it temporarily to replenish the cash balances of the Government of India.

The Gold Standard Reserve had become the pivot of India's monetary mechanism, and the coinage of rupees regularly effected, went on adding to its size along with the interest accruing upon the securities in which it was invested. At the end of the official year 1916–17, the total of the Reserve stood at £ 31·5 millions, more than £ 4 million being added to it on account of the huge coinage of rupees the government had to undertake to replenish its dwindling stocks. The loan taken from the reserve was returned to it in the course of the year, and £25·4 millions were invested in London, £6 millions having been placed at short notice by the Secretary of State for India. The holdings in the Gold Reserve on 31st March, 1918, were estimated at £34·31 millions and out of this, £28·31 million was invested in London, the remaining £6 million being placed at short notice in the same place. There was not an ounce of this gold in India at the close of 1917–18. "On March 31 st, 1918, the total profit on coinage since 1900, was £28,843,592; the interest and discount, £8,074,195 and the profit by exchange, £194,966, a total of £37,112,703. Of this sum, £1,123,656 had been used for capital expenditure on railways; the remainder has been credited to the Reserve. The total interest and discount including the profit on exchange, up to March 31st, 1918, were £8,269,111, and the total losses through depreciation, sale and redemption of securities, &c. were £1,535,606. There was thus a net profit on investments upto March 31st, 1918, of £6,733,505."[1] By the year 1925, the Reserve

1 G. Findlay Shirras: Indian Finance and Banking.

exceeded £40 million and almost the whole of it was held in securities in London, a substantial proportion being in British Treasury Bills. The interest on the investments had risen to about £13 million by 1924. Under the Paper Currency Act of 1920, the excess of the Reserve over £40 million was used to strengthen the Currency Reserve and after 1923, the interest was appropriated to revenue. The balance of the Gold Reserve on 31st March, 1929, was as follows:—

In England

		£
Estimated value of sterling securities of the nominal value of £ 38,139,000	...	37,844,024
Gold	...	2,152,334
Cash at Bank of England	...	3,042
Total	...	40,000,000

The other recommendations of the Chamberlain Commission will be discussed in their proper place. As indicated above, it placed the seal of its approval on the theory and the practice of the gold exchange standard whatever improvements it might have suggested in its actual management; and in doing so, frankly stated that the system developed by government in India for the establishment of the exchange value of the rupee on a stable basis, had been "necessarily and rightly rather supplementary to, than in all respects directly in pursuance of the recommendations of the committee oi 1898." The stability of the rupee-sterling exchange—which was the sole preoccupation of government—having been attained, and the means adopted for securing the aim having been generally approved, the Chamberlain Commission naturally thought that "the time had arrived for a reconsideration of the ultimate goal of the Indian currency system." The fundamental difference between the main principle laid down by the Fowler Committee and the attitude of the Commission was brought out in the following observation:—"The belief of the Commission of 1898 was that a gold currency in active circulation is an essential condition of the maintenance of the gold standard in India, but history of the last fifteen years shows that the gold standard has been firmly secured without this condition." The Commission added:—"It would not

be to India's advantage to encourage an increased use of gold in the internal circulation. The people of India neither desire nor need any considerable amount of gold for circulation as currency, and the currency most generally suitable for the internal needs of India consists of rupees and notes." While holding that "it would not be to India's advantage to encourage an increased use of gold in the internal circulation," it recommended that "the Government should continue to aim at giving the people the form of currency which they demand, whether rupees, notes or gold, but the use of notes should be encouraged."

182. Comment and Conclusion:—The assumptions of the Chamberlain Commission that the Government of India had given the people what currency they wanted and that there was no popular demand for gold in circulation were not founded on facts. A gold currency as an accompaniment of the gold standard has never been given a fair trial, and the circumstance that in any event large quantities of rupees are needed by the mass of the population for daily transactions, proves nothing because gold coins are not expected by any body to supplant the silver currency. The very inconvertibility of the silver (rupees) and paper notes into gold must prevent the use of sovereigns as currency and the latter are bound to be used, to a great extent, for melting and hoarding. The public looks at the rupee and the paper currency with distrust, and no monetary reform is possible until confidence is restored by the introduction of convertibility of the currency into the standard metal. It is pertinent to point out that gold has been extensively imported into India in spite of the exchange standard and that it is unwise to encourage the bulk of it to go into private hoards rather than induce the public to use it partly for monetary and industrial improvement. If the Indian public prefers rupees to gold coins in active circulation it is in the same position as the people in countries having the gold standard, and there is no apparent reason why the former should be denied a monetary system which prevails there.

The Commission appears to have unconsciously placed itself in a dilemma. If people do not desire gold for purposes of currency, as it declares, there is no harm in making the fiduciary money convertible as there would be no waste involved and the policy would, on the contrary, prove helpful. If the public does want a gold

currency, the Commission emphatically asks government to provide the public with what it requires. But will not gold in central reserves be more useful in maintaining the stability of exchange when the trade balance is adverse than gold coins in the pockets of the people? The answer is that the gold in circulation will be in addition to what will be kept in the reserves and is not to replace it and will thus make the exchange position stronger.[1] The gold reserves themselves will be ampler if the paper currency is made convertible in gold and the rupee is limited legal tender. The use of gold as currency can not but be on a small scale. It will not be used for large payments, notes being more convenient for the purpose; and for small payments, rupees will be found more suitable. It is the predominant position which has been accorded to the rupee as a legal tender to an unlimited amount and the refusal of the government to make notes convertible in the standard metal and to accord to gold its legitimate status, that is the real obstacle to progress. It is needless to repeat that the analogy of other countries which have adopted the exchange standard, either fully or partially, does not apply to the peculiar conditions of India, and the last support of the fabric reared by the arguments of the Chamberlain Commission falls to the ground when it is stated that the 'managed' currency has been far from automatic and conducive to economic development. If the exchange standard were the ideal standard it is claimed to be, European countries would not be in such a hurry to run away from it. It is regarded by them only as a stepping stone to the true gold standard, and the restoration of the latter is eagerly sought where a departure from it had been imposed on them by the force of circumstances.

To conclude: Schemes of a monetary standard without gold as a regulator of values and based upon varying index numbers of prices or merely on gold lying in the vaults of the leading central banks of the world, evolved by economists[2] desirous of providing

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1 For a more detailed critical examination of the arguments of the Chamberlain Commission, read *Indian Currency and Exchange* by Prof. H. L. Chablani.

2 "Whereas Fisher's standard of value is still based on gold, though in an essentially modified form, Keynes dethrones gold altogether."—"Handbuch der Finanzwissenschaft," Vol I, page 83

for an assured stability of prices and of overcoming the difficulties caused by the use of the precious metals in currency systems, still lie in the dim distance as desirable ideals. In the world, as we have it to-day, gold will continue to occupy a commanding position in public estimation for currency and banking systems.[1] Before the War, nearly one-third of the world's gold production used to be employed in the arts, and the share of Western nations in this non-monetary use of gold was not small, Germany, England, U. S. A. and France each diverting annually from five to nine crores worth of gold for these industrial purposes[2]. Indian consumption of gold is, therefore, nothing exceptional, and the outcry against it, is meaningless. Though it is not easy to forecast the future of gold production, there is no reason to believe that there will be an inconvenient shortage in the available supply. Nor is there any scientific basis for the opinion that a gold exchange standard is better than a gold currency standard. It is true that nations can not build up and work their monetary systems in isolation, but each of them must adjust its own system according to its special opportunities and its economic, social and political conditions. This attitude is bound to prevail in international conferences and in understandings which have been and will be arrived at on the subject. It was a blunder to have introduced the gold exchange standard in India; it will be another to perpetuate it even in the form of the bullion standard.

183. Paper Money:—As according to the "State theory," money is a creature of law, it may be made from paper as from the metals. But although the authority of the government can create legal currency, paper money is usually only accessory and is convertible into standard money at the will of the holder, a bank or government office being under the legal obligation to pay coin for paper. It follows, therefore, that there must be sufficient standard money in stock to convert the paper presented for encashment. Still the use of paper money in excess of the specie kept in reserve, means to the bank or government issuing it, so much purchasing power created out of nothing. The risk of overissue has, therefore, to be guarded against. Treasury and bank 'notes' stand midway between

1 See Dr. Adolf Weber's "Allgemeine Volkswirtschaftslehre."

2 See Philippovitch; "Grundriss," Vol I.

inconvertible paper on the one side and bullion certificates on the other, the former having no metallic backing and the latter being fully covered with a bullion reserve. The difference between the amount of notes issued and that of the metallic reserve, may be invested so as to earn interest. To economise the use of the precious metals and to supply to the public a more convenient form of currency, governments and banks issue paper money, which occupies a large place in the currencies of the advanced nations. The cheque in England and the bank note on the continent, are extensively used as media of exchange, and metallic money occupies only a very subordinate position in the currency systems there. The right of issuing notes is a monopoly enjoyed by banks in certain countries while in others, banks are allowed to exercise this function freely.[1] As the right to coin money out of paper is likely to be abused to the detriment of the public, the issue of notes is generally regulated by the State in all countries. Where there are State banks, as in Russia, there is no question of the control of government. In countries like England, France and Germany where the connection between the central bank and the State is very intimate, and in America, where there are numerous private banks enjoying the right of note issue, the regulation of the issue of notes is found necessary in the interests of the public.

There has recently been a great expansion of paper currency in India (and on a vastly larger scale in other countries), the shortage of money caused by the demand of war expenditure having necessitated the issue of large quantities of notes. The currency thus expanded, would have been steadily deflated as the demand for it decreased and government proceeded to cancel the superfluous notes as they were received in the treasuries. But this process of deflation had practically to be stopped owing to lack of resources, the rather inconvenient dimensions of the floating debt and the seasonal monetary stringency which resulted. The use of cheques in ordinary transactions, is limited in India; and though the progress of paper circulation is satisfactory, and was exceptionally rapid in time of war, there is yet an unlimited field for the

1 Though there is no monopoly of issue in the U. S. A., the privilege of note issue enjoyed by banks is hedged in with various conditions and restrictions.

expansion of paper currency. There will be an apparent set-back in this regard from the war time position, for a few years, but the popularity of paper money is bound steadily to grow with educational and economic progress. Prejudice born of ignorance and distrust, will disappear with familiarity, and government's policy of 'universalizing' notes i. e. making them encashable in all parts of the country, whatever the circle of issue, has already contributed to the expansion of paper currency. The poorer classes find it difficult to keep and handle paper money in India and hence its progress in villages, is slow. The preference shown for metallic money by the mass of people in this country, is due to their social habits and their poverty; and this fact must not be lost sight of in criticising their love of that form of currency and ought to moderate our enthusiasm for the promotion of the use of paper as an instrument of exchange. The smallest denomination of paper money is five rupees, and the one rupee note is no longer issued, though its use has been recommended by the Hilton Young Commission. Consequently, paper hardly circulates in rural areas and the bulk of the population satisfies its currency needs with metallic money. The one rupee note was slowly increasing in popularity when the government ceased to issue it, economy in public expenditure being one of the reasons justifying that step. Any forcing of the pace in this matter is, of course, to be deprecated as the issue of a large amount of token currency may only drive the people to gold and encourage hoarding among them. Spread of education, progress of industries and commerce and the policy of government tending to popularise currency notes, will encourage a larger use of paper substitutes for metallic money.

184. State Paper Currency:—Instruments of credit were in use among bankers and merchants in old times; but bank notes and notes issued by the State as a part of national currency, were not known. This is a development of the past seventy years. A few commercial houses in Calcutta used to issue their own notes in the early years of the last century; but their circulation was naturally limited to a small area and amount. In the forties of the last century the three Presidency Banks were authorised by law to issue notes which were not, however, legal tender and whose circulation was circumscribed. The notes were payable on demand and the maximum limit of issue was fixed. The scope for the use of paper

money was small and little progress was made during the next twenty years.[1]

Mr. James Wilson, the first Finance Member of the Governor-General's Council, initiated a new policy by introducing a Bill relating to the paper currency in India in 1860. He pointed out in his speech before the Legislative Council the advantage of a government paper currency to be managed entirely by the State. "The Government of India," he said, "proposed to take the issue department of the Bank of England as their model."[2] Notes, which are only silver or gold certificates, representing a store of the precious metals of equal value kept in reserve, represent little improvement upon metallic money as they do not yield any profit or economy; and fiat money or inconvertible paper money has its obvious dangers. The Government of India placed before itself as its ideal and guide the English Bank Charter Act of 1844 and imposed a limit of amount upon the fiduciary issue, thus, in a way,

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1 "Under Acts of the Governor-General, Nos. VI of 1839, III of 1840 and IX of 1843, the Presidency Banks of Bengal, Bombay and Madras were authorised to issue notes payable on demand, but the issue of the notes was practically confined to the three cities of Calcutta, Bombay and Madras. These notes were not legal tender. The issues were limited to maxima of two crores of rupees in the cases of Banks of Bengal and Bombay and of one crore in that of the Bank of Madras. These Acts were repealed by Act XIX of 1861, providing for the issue of a paper currency through a Government Department by means of notes of the Government of India payable to bearer on demand. These notes were made legal tender within the circles of issue. Since the 1st March, 1862 when this Act took effect, no banks have been allowed to issue notes in India."—Memorandum submitted by Mr. F. W. Newmarch to the Chamberlain Commission.

2 "Not only would such an issue department possess a security greater perhaps than that of any bank of issue in the world, but there would be a large direct profit to the State from the interest derived from the fiduciary portion of the reserve and an indirect advantage in the improvement of Government credit from the purchase of securities for the paper currency reserve. I should mention that Mr. Wilson's bill did not become law without considerable modification, the principal being that the last denomination of note was fixed at ten rupees instead of five, and that the fiduciary portion of the reserve was limited by the Act, as passed, to four crores of rupees instead of two-thirds of the note circulation proposed by Mr. Wilson."—Evidence of Mr. F. W. Newmarch before the Currency Commission, 1913.

rendering the system inelastic. That limit has been raised from time to time as the circulation of the currency notes has steadily expanded. The issue of bank notes is regulated by the State in all countries. A reserve of gold and silver is insisted on as a guarantee for the encashment of the notes whenever they are presented, and the amount of the notes which need not be so secured by a reserve, is strictly limited by law, a departure being allowed therefrom only under specific conditions. The portion of the note issue not covered by a reserve of cash, may bear a certain ratio to the total circulation or may be a fixed amount to be automatically raised with the increase of issue.[1]

It was provided by the Act of 1861 that bullion and coin should be held as a reserve to encash the notes issued with the exception of such an amount not exceeding four crores of rupees as the Governor General in Council with the consent of the Secretary of State for India might from time to time fix. This amount was to be invested in "Government securities." The country was divided into a number of circles, with places of issue, the Presidency towns being three such places; and the encashment was limited to the circles, within which only the notes were legal tender. In December, 1863, the note issue was valued at Rs. 5,11,00,000 and the Reserve was composed thus :—

			Rs.
Silver Coin Reserve	...	...	1,93,22,868
Silver Bullion Reserve	...	...	1,17,00,000
Government Securities	...	...	2,00,77,132
			5,11,00,000

185. Currency Reserve:—The invested or fiduciary portion of the Reserve was thus about two-fifths of the total circulation though it was limited by a fixed amount and not by the ratio it bore to the total note circulation. The maximum fiduciary issue, which was originally limited to 4 crores, was raised to 6 crores in 1872 by Act III of 1871; to 8 crores in 1890 by Act XV of that year; to 10 crores by Act XXI of 1896; to 12 crores by Act III of 1905; and to 14 crores

1 Compare the British, French, American and German systems in this connection.

by Act VII of 1911. Originally, the securities in which a portion of the paper currency reserve was to be invested, were to be 'securities of the Government of India'; but when in 1905 the limit of the fiduciary issue was raised to 12 crores, 'securities of the United Kingdom of Great Britain and Ireland' and 'securities issued by the Secretary of State for India in Council under the authority of Act of Parliament, and charged on the revenues of India,' were added, the value of the latter classes of securities being limited to 2 crores. When in 1911 the limit of the invested portion was raised to 14 crores, it was provided that 4 crores out of this amount might be invested in securities other than those of the Government of India. These facts may be conveniently presented in tabular form thus :—

Maximum Investment.

(Crores of rupees.)

		India	England	Total
Act XIX of 1861	...	4	0	4
„ III of 1871	...	6	0	6
„ XV of 1890	...	8	0	8
„ XXI of 1896	...	10	0	10
„ III of 1905	...	10	2	12
„ VII of 1911	...	10	4	14

As will be shown below, the permissible invested portion was ultimately raised from the 14 crore limit to Rs. 120 crores, and the bulk of these securities were, during war time, British Treasury Bills. By the Indian Paper Currency (Amendment) Act, Act VI of 1918 and by Act II of 1919, the maximum limit for the issue of currency notes against Treasury bills, was successively raised from 48 to 86 crores, and the total permissible amount of securities went up to 100 crores of rupees. Owing to difficulties in the ways and means position, government took legal powers in September, 1919, by Act XXVI of 1919, to increase the permissible holdings of securities in the Paper Currency Reserve to £ 80 million or 120 crores of rupees though there was no occasion to utilize that power. The character and the locale of the securities were radically altered in the course of 1920–21 in consequence of the sale, by the Secretary of State, of sterling

securities to the amount of $36\frac{1}{2}$ million in replenishment of his treasury balances depleted by the new exchange policy adopted in conformity with the recommendations of the Babington Smith Committee. The holding of Indian treasury bills, therefore, exceeded Rs. 61 crores at the close of 1920-21. The percentage of securities in the Reserve to the total circulation of notes, was 22 during the pre-war quinquennium. It rose to 29 in 1916, to 56 in 1917, to 62 in 1918 and to 65 in 1919. The difficulty of obtaining the precious metals and supplying metallic currency during war time, naturally reduced the ratio of metal to securities in the reserve; and the proportion gradually rose again in post-war years, though the level of 1914 could not long be reached. The composition of the Reserve has undergone important changes from time to time as regards the holdings of gold, sterling securities, treasury bills, British and Indian, created or *ad hoc* securities and silver, owing to revaluation of gold and gold securities with the alteration of the exchange ratio and the transfer and liquidation of securities. These changes will be explained in succeeding sections. The following tables will, in the mean while, give certain relevant figures:—

I

Investment of Reserve.

(Crores of Rupees.)

	Permanent	Permissible temporary	Total
Act VII of 1911	14	...	14
„ V of 1915	14	6	20
„ IX of 1916	14	12	26
„ XI of 1917	14	36	50
„ XIX of 1917	14	48	62
„ VI of 1918	14	72	86
„ II of 1919	14	86	100
„ XXVI of 1919	20	100	120

II

Composition of Reserve.

(A)

(In Crores of Rs.)

Last day of Month	Gross Note Circulation	Gold		Silver		Securities			Percentage to Gross Note circulation of			
		In India	Out of India	Coin	Bullion	Indian	B. Treasury Bills	Other	Gold	Silver	Gold and Silver	Securities
1914	66·1	22·4	9·1	20·5	...	10·0	...	4·0	47·8	31·0	78·8	21·2
1915	61·6	7·6	7·6	32·3	...	10·0	...	4·0	24·8	52·5	77·3	22·7
1916	67·7	12·2	11·9	23·0	·5	10·0	6·0	4·0	35·8	34·8	70·6	29·4
1917	86·3	12·0	6·6	17·0	2·1	10·0	34·4	4·0	21·6	22·2	43·8	56·2
1918	99·7	26·8	·6	10·4	·3	10·0	48·1	3·3	27·6	10·8	38·4	61·6
1919	153·4	17·3	·1	16·6	20·7	16·0	81·2	1·2	11·4	24·4	35·8	64·2
1920	174·5	44·3	3·4	33·2	6·6	19·5	67·2	...	27·4	22·8	50·2	49·8
1921	166·1	21·1	...	61·4	4·1	68·0	8·3	...	14·5	39·5	54·0	46·0
1922	174·7	24·3	...	72·9	4·5	67·0	5·8	...	13·9	44·4	58·3	41·7
1923	174·7	24·3	...	82·5	4·5	57·4	5·8	...	13·9	49·8	63·7	36·3
1924	185·8	22·3	...	74·1	5·8	69·5	14·0	...	12·0	43·1	55·1	44·9
1925	184·1	22·3	...	70·0	6·7	65·1	20·0	...	12·1	41·7	53·8	46·2

(B)

(Crores of Rs.)

Month	Gross Note circulation	Silver		Gold Coin and Bullion in India	Sterling Securities in England	Rupee securities in India	Internal Bills of Exchange
		Coin	Bullion				
31st March 1926	193·3	77·2	7·6	22·3	29·0	57·1	...
" " 1927	184·1	95·9	8·5	22·3	5·5	49·7	2·0
" " 1928	184·8	98·7	7·6	29·7	3·7	37·9	7·0
" " 1929	188·0	94·9	4·9	32·2	10·6	43·2	2·0

186. Composition and Location :—For several years the Paper Currency Reserve was kept mainly in silver and in India, its

primary purpose being the encashment of notes in rupees. But in 1898 this policy was, for the first time, departed from, and a portion of the Reserve was located in London to be used for the purchase of silver for rupee coinage and also for the support of exchange. In 1898 an Act was passed (II of 1898) enabling notes to be issued against gold held by the Secretary of State in London. This Act was a temporary measure intended to meet exceptional conditions. The Secretary of State sold bills beyond his own requirements for the convenience of trade, but the Government of India could not meet them from their balances. The above Act was intended to enable them to meet the drawings from the Paper Currency Reserve, the Secretary of State setting aside gold to the account of that Reserve in London to the same amount as the Government of India took out from the Reserve in this country to meet his drawings. This temporay arrangement was extended by two years, and then in 1902, by Act IX of that year, was made permanent. The Secretary of State was enabled by this Act, to purchase silver bullion and to transmit it to India for currency purposes. Thus the Secretary of State might either (1) hold gold in England as part of the Reserve against the note issue in India, or (2) he might transmit the gold to this country to serve the same purpose here or (3) he might expend it on the purchase of silver, also to form part of the Reserve. Gold or silver in transit to India from its location as part of the Reserve in England or *vice versa*, remains part of the Reserve while in transit. In practice only the first and the third of the above alternative courses are adopted as ordinarily sovereigns 'are imported on private account in sufficient quantities into India and render it unnecessary for the Secretary of State to ship them.'

If the silver required for coinage purposes can not be purchased in India,[1] it is but reasonable that a part of the Paper Currency

1 The necessity and wisdom of transferring even a part of the Reserve to London have been doubted and it is urged, with much show of reason, that silver purchases should be regularly and directly made in India through Indian dealers. India has a large bullion market, e. g. Bombay, and it is capable of great expansion. It is not an extravagant but a legitimate demand to ask government to make its silver purchases in this country. This suggestion, if adopted, will benefit Indian dealers without causing inconvenience or loss to the government. But silver trade is controlled by a few powerful firms in London; and vested interests and the diffidence of government as regards the economical, safe and smooth working of the proposed arrangement, stand in the way. The same remark applies to the government's sales of silver through the same firms, carried out in recent years.

Reserve should be transferred to London by the sale of Council bills to enable the Secretary of State to make the necessary purchases whenever necessary. But the portion of this Reserve located in London, came to be regarded as a first line of defence in a time of an exchange crisis, and strong objection was taken to the utilization of the Currency Reserve, which is intended mainly to enable the Government of India to encash its notes, for supporting exchange, and to such investment and locking up of large funds in England. It was argued that the English joint stock banks worked with a very small reserve of gold and relied too much on the Bank of England and that it was dangerous to hold the gold of the Currency Reserve ear-marked at that Bank. The general objection to the transfer of Indian gold to London in the case of the Gold Standard Reserve applied with greater force to the gold in the Currency Reserve. The government, however, replied that if the gold on account of the Reserve were not drawn to London, it would, in any case, have to be transferred there for the purchase of silver when the stock of rupees was depleted and gold in India could not serve the purposes of currency. It was stated that "the gold in the Reserve in India has been much in excess of the demand, that the Gold Standard Reserve has not in itself been sufficient to secure beyond question the stability of exchange, and that gold in London is more directly and indubitably effective for this purpose than gold in India."

187. Introduction of Elasticity:—The government's policy in managing the Paper Currency Reserve was conservative in the extreme, and underwent unconscious changes only while drifting along or when it was forced by the irresistible impulse of circumstances. It has been already indicated that the system of paper currency in India was characterized by a rigidity copied from the British system which is based on what is known as the 'currency principle' (as opposed to the 'banking principle,') requiring that except for a small fixed amount, the note issue should be fully covered by a metallic reserve. The lack of elasticity in the British system is mitigated by the extensive use of cheques while in India there are no such means of expanding the media of payment. In this country great caution has, of course, to be exercised in matters like the modification of the provisions for the ensurance of the convertibility of notes; but apart from the extraordinary measures which the

government was compelled to take to meet war conditions, some relaxation of rigidity of the organization of paper currency was found necessary even by the Chamberlain Commission. When the maximum limit for the invested portion of the Reserve was reached, any further increase in the note issue required the deposit of an equal amount of gold or silver in the Reserve. If an increase in the amount of the invested portion was thought expedient, legislative sanction was necessary for the step. The required improvement could be effected "if instead of laying down that the invested portion of the reserve must not exceed a fixed maximum, the legislature prescribes that it shall not exceed a maximum percentage of the total issue; or alternatively, that the metallic portion shall not fall below a maximum percentage of the total issue." The Chamberlain Commission realized the importance of modifying the existing system along these lines and recommended that the fiduciary portion of the paper currency reserve should be increased at once to 20 crores and should thereafter be fixed "at a maximum of the amount of notes held by the government in the Reserve Treasuries *plus* one-third of the net circulation."

The Babington Smith Committee endorsed the principle underlying this proposal but thought that in the altered circumstances of the time, the suggested reserve would be too large for the requirements of the country and therefore recommended that "the statutory minimum for the metallic portion of the reserve should be 40 per cent. of the gross circulation." It also accepted the Commisson's recommendation (which had already been given effect to by means of temporary legislation) that the limit of the Indian government's securities in the invested portion of the Reserve should be fixed at 20 crores. With the object of promoting elasticity, the Commission had suggested that the "government should take power to make temporary investments or loans from the fiduciary portion within this maximum in India and in London as an alternative to investment in permanent securities." The Committee went further, and in order to provide for additional limited power of expansion with a special view to meeting the seasonal demand for the expansion of currency normal in India, recommended that authority should be taken, in the first instance, to issue notes, up to 5 crores on the security of commercial bills of exchange to supplement the ordinary issue. It was laid down that the proper place of the Paper Currency

Reserve, both silver and gold, is India except for temporary location in London in view of payment for the purchases of silver. The necessity of earmarking gold belonging to the Currency Reserve at the Bank of England which is said to be 'equivalent to the export of gold from London to India,' because that gold so set aside against notes issued in this country, is not available to the London market, was temporarily removed by an amendment of the law, and the Secretary of State for India was empowered, as we have seen, by successive steps, to invest the Reserve there up to a total amount of Rs. 100 crores, this limit of securities in England having been only 4 crores before the out-break of the war.

The elasticity imparted to note circulation during the trying times of war, had to be converted into a permanent feature of the system, and the advantages of the reform, pointed out by the Chamberlain Commission, viz. amelioration of monetary stringency and the profitable utilization of funds which would otherwise have to lie idle, without any risk to encashment of notes, had to be secured. Act XIV of 1920 (and the consolidation Act of 1923), therefore, provided for the statutory constitution of the Paper Currency Reserve while providing for a transitional period of adjustment. It laid down the maximum limit of the gold holdings of the Secretary of State at 5 crores and restricted the security reserve in London to securities which are not of a longer maturity than one year. Out of the 20 crores of Indian securities not more than 12 crores may be securities created by the Government of India and issued to the Controller of the Currency. The Act prohibited the issue of currency notes if such issue would have the effect of raising the amount of notes in circulation to more than twice the amount of the metallic reserve. Under section 19 of the Act of 1923 it was provided that until the permanent provision in that behalf could be put into force, the total amount of securities in the Reserve was not to exceed Rs. 85 crores, exclusive of the Rs. 12 crores in the form of bills of exchange. It was felt in 1925 that this limit would prove too narrow and early in that year the permissible size of the security holding was increased by legislation to Rs. 100 crores, with the proviso that the value of created securities should not exceed Rs. 50 crores. A large portion of the Indian invested reserve since 1918 consisted of 'created securities,' that is to say, treasury bills issued by government to itself. Currency notes were

issued by government against its own I. O. U.s, and this watering down of the currency meant a floating public debt without obligation to pay interest thereon. These treasury bills issued to the Reserve had to be withdrawn before the Reserve could approximate to its statutory constitution. The Paper Currency Act has been successively amended to authorize the issue of notes against the security of commercial bills for the purpose of relieving monetary stringency during the busy season. Power had been taken in 1920 to issue currency notes upto Rs. 5 crores against bills of exchange maturing in 90 days, but rules were not made in this connection until 1922. Continued monetary stringency led to amending legislation in 1923-24 and the maximum limit of seasonal issue was raised from 5 to 12 crores. The regulations in this connection as to the amount of the loans to be given to the Imperial Bank of India against bills held in the Currency Reserve and the rates of interest to be charged thereon were revised now and again to facilitate the attainment of the end in view, viz. relieving stringency.

188. Note Circulation:—Indian currency notes are in the form of promissory notes of the Government of India, payable in rupees to bearer on demand, and are issued in denominations of 5, 10, 50, 100, 1,000 and 10,000. They are issued without limit at any paper currency office against rupees or gold. For the purpose of the note system, India is divided into seven circles,[1] and (with the exception of the 5 rupees note which was universalised outside Burma in 1903) the notes were, until 1910, legal tender only within the circle of issue. Since then all the smaller denominations of notes up to and including those for 100 rupees, have been universalised. The size and the form of the notes have now been greatly improved and their popularity has increased as a consequence. Provision has been made for the printing of the notes in India, viz. at Nasik in the Bombay Presidency at government's own Security Printing Press.

An urgent demand for currency which could not be satisfied with the available stock of rupees, led the government to think of issuing notes of such very small denominations as one rupee, in imitation of the one £ and 10 s. notes issued in England, to satisfy the enormous currency needs of the war-period. The one rupee notes

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1 The seven circles: Calcutta, Cawnpore, Lahore, Bombay, Karachi, Madras and Rangoon.

were issued on 1st December, 1917 ; and notes of the denomination of Rs 2½ on 2nd January, 1918. The issues were first confined to the three Presidency towns aud special facilities were given for their encashment at the Post Offices. In the course of a few months their total issue reached a value of Rs. 45 lakhs, and the encashments amounted only to Rs. 11 lakhs. On 31st March, 1919, the values of the 1 rupee and 2½ rupees notes in circulation were about 10½ crores and 1¾ crores respectively. These notes were primarily issued with the object of supplying additional currency and economising the use of silver which had become unprecedentedly scarce and dear. The average gross circulation of notes was 28·58 crores in 1900–01, 45·14 cores in 1906–07, 65·62 crores in 1912–13, 64 crores in 1915–16 ; 101 crores in 1917–18, 133 crores in 1918–1919 ; and the circulation exceeded 180 crores in 1919–20. The following table shows the gross, the net and the active average circulation[1] of currency notes during the past few years :—

	Gross circulation (crores of Rs.)	Net circulation (crores of Rs.)	Active circulation (crores of Rs.)
1904–05 ...	39·2		28·1
1910–11 ...	54·3		38·7
1913–14 ...	65·5		46·6
1914–15 ...	64·0	56·5	45·4
1915–16 ...	64.1	57·5	48·0
1916–17 ...	76·1	69·3	59·3
1917–18 ...	101·7	93·6	71.8
1918–19 ...	133·2	127·2	113·8
1919–20 ...	171·6	166·3	151·1
1920–21 ...	163·5	159·2	138.8
1921–22 ...	173·1	171·3	152·2
1922–23 ...	176·3	174·3	153·2
1923–24 ...	179·0	177·2	156·0
1924–25 ...	179·2	177·7	160·9
1925–26 ...	186·8	185·5	163·1
1926–27 ...	189·1	187·9	156·3
1927–28 ...	180·1	179·0	162·6
1928–29 ...	184·8	183·8	171·9

1 The 'gross' circulation consits of the total amount of notes issued. The 'net' circulation is obtained by deduction from the gross amount the quantity of notes held in Government Treasuries. We get the 'active' circulation if notes held in the Local Head Offices of the Imperial Bank of India are further deducted.

The expansion of the circulation of notes shows a steadily increasing amount of currency absorption. Prevailing high prices, the heavy governmant disbursements on account of war, the disappearance from circulation of huge quantities of rupees coined and the uncovered issues of paper money on an enormous scale, combined to expand the media of exchange. Currency is said to be absorbed when instead of returning to government treasuries, it remains in the hands of the public and is the net addition to circulation. The absorption can be found by adding together the coinage of rupees and sovereigns, the net imports of sovereigns and the issue of notes and deducting from the total the increase that may have taken place in the Treasury balances of government. The following table shows the comparative total absorption of each form of currency[1] :—

Curreney Absorption (In crores of Rs.)

	Rupees	Notes	Total	Sovereigns	Grand Total
1909–10	13·22	5·03	18·25	4·31	22·56
1911–12	11·50	4·44	15·95	13·33	29·27
1913–14	5·32	2·65	7·97	18·11	26·08
1914–15	–6·70	–6·01	–12·71	8·43	–4·29
1916–17	33·81	13·89	47·70	3·18	50·88
1918–19	45·02	49·29	94·31	5·21	99·52
1919–20	20·09	20·20	40·29	–3·32	36·97
1920–21	–25·68	–5·90	–31·68	–4·38	–35·96
1921–22	–10·46	9·35	–1·11	2·78	1·67
1922–23	–9·56	3·87	–5·69	9·43	3·74
1923–24	7·62	7·96	15·58	6·74	22·32
1924–25	3·65	–2·51	1·14	14·53	15·67
1925–26	–8·17	1·16	–7·01	11·77	4·06
1926–27	–19·76	–3·40	–23·16	6·24	–16·92
1927–28	–3·75	10·22	6·47	...	6·47
1928–29	–3·03	3·66	·63	...	·63

The above figures are extremely instructive. They show how radical changes occurred in the position with reference to the public absorption of currency just after the out-break of the war and on its termination, and how they have made themselves conspicuous recently, again, particularly in the matter of a return of rupees from

1 From 1st April, 1927 sovereigns and half-sovereigns ceased to be legal tender, and this coin does not, therefore, figure for the last two years in the table.

circulation. There are indications to show that while there is a superfluity of rupees with the people, notes are being substituted for them on a steadily growing scale in rural as well as urban areas. The notes of the denomination of Rs. 10 and Rs. 100 are the most popular, and account for 41 per cent. and 36 per cent. of the total circulation respectively. The five rupee note is, at the same time, finding greater favour with the public. The highest percentage of one rupee notes was 8·9 in 1919–20, the $2\frac{1}{2}$ rupee notes never found favour with the public and 20 and 50 rupee notes have not been issued for years. The issue of the one rupee note was definitely discontinued from 1st January, 1926. The circulation of 10,000 rupee notes is negligible. The following table gives a comparative view of the circulation of each denomination of note on 31st March for a number of years :—

Note Circulation showing the values of notes of each Denomination.

Denomination of Notes.	Value of notes (In crores of Rs.)					
	31st March, 1914	31st March, 1917	31st March, 1920	31st March, 1924	31st March, 1927	31st March, 1929
1	...	...	13·49	11·39	·4	·3
$2\frac{1}{2}$	...	...	1·08	0·7	·02	·01
5	1·61	3·31	11·45	15·90	16·4	23·7
10	17·73	22·60	54·73	57·78	72·8	74·5
20	·8	·5	·03	·02	·02	·02
50	1·78	2·52	4·90	3·12	2·1	2·1
100	17·81	25·32	50·38	69.41	60·09	65·7
500	2·64	2·45	2·63	1·62	1·1	·9
1,000	9·17	11·24	16·20	12·87	13 4	12·6

189. Currency Operations :—It should be emphasised that the Government of India and the Secretary of State perform several

functions which, in other countries, are left to private and State banks; and issue of currency and remittance of funds have to be managed by a government department. But it has been long realized that the day would not be far distant when this banking business of the State would have to be transferred to a central institution like the Imperial Bank of India. The connection between the Indian government and movement of trade, internal and external, is very intimate to-day; and the financial operations of the Currency Department and of the India Office, are on an extensive scale. The backwardness of national banking, the Treasury system of government and its management of exchange and currency, which are of the nature of ordinary banking functions, necessitate these operations on behalf of the State. With the expansion of the business of the Imperial Bank of India through its new branches spread all over the country and the transfer to it of the functions of State treasuries, this work has been steadily reduced. The establishment of the Reserve Bank, entrusted with the management of paper currency, must radically modify the whole system. As matters stand, funds have to be moved from treasury to treasary and from currency chest to currency chest to meet the seasonal demand arising from the necessity of financing export trade. Indian crops are harvested and moved for export at different times of the year but it is mainly during the busy season between October and April that the demand for currency is very great and has to be satisfied through currency offices, banks and treasuries.

" Briefly the position is that in addition to the Treasury, Currency Reserve and Gold Standard Reserve Balances at Head-quarters, Government hold large amounts of money distributed over India in District treasuries and in currency chests, nearly every treasury having such a chest. Money comes into the Government treasuries and sub-treasuries all over the country in payment of revenue, from which it is necessary to provide funds for expenditure at Head-quarters or in order to meet outgoings in England. Conversely, the trading firms have large remittances to make to the interior, in payment for produce. Firms requiring money for this purpose constantly apply to Government for remittance orders from one place to another within the country, and Government meet their requirements so far as they can do so, by the issue, at a small charge, of supply bills and telegraphic transfers through treasury

or currency. The amount of remittances annually effected in this way is very large. The arrangement is economical for all parties concerned as enabling these transactions to be largely effected without any actual movement of coin."[1] We propose to notice, in the next Chapter, a similarly intimate relation which subsists between the banking operations of government and the adjustment of the transactions of India's external trade, which will be fundamentally altered on the establishment of a central Reserve Bank.

As far as the government is concerned, funds are moved from one treasury to another to supplement the money available there. Government likewise remits funds, at a small charge, for the convenience of trade by issuing transfers on its treasuries. The paper currency reserve is kept in special 'chests' which are located at each treasury and sub-treasury, and transfers are made through these chests. If a certain treasury is short of funds, it may take the amount it requires from the currency chest, and a corresponding transfer from the treasury to the currency chest is made at some other place, where there are surplus funds at the time. The aggregate value of transfers 'through currency' in 1918-19, amounted to 55·13 crores of rupees and the total movement of funds through treasuries as well as through currency offices, amounted to just over 100 crores. As indicated above, the Imperial Bank is now doing a considerable part of the work of moving funds as it is entitled to transfer its funds through currency free of charge; and government has discontinued the issue of currency transfers or supply bills between any two places in which a Local Head Office or a branch of the Bank is situated. The total movement of funds through government agency, i. e. through treasuries as well as currency offices, amounted, in 1920-21, to 87⅓ crores as compared with 107⅓ crores in the previous year. In later years there is a progressive contraction in the size of these transactions and corresponding expansion in that of the Imperial Bank's operations. The amount of the demand drafts purchased and drafts and telegraphic transfers paid by the Imperial Bank in each half-year averages 70 to 80 crores of rupees. The remittance of funds through government agency, e.g. through treasuries and currency offices, amounts roughly to

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1 Report upon the Operations of the Currency Department during the year 1913-14.

12 crores within the Provinces and 7 to 9 crores a year as between the Provinces[1]. The popularity of the note currency is steadily on the increase as we have stated above, and the encashment of notes, temporarily restricted during war time, having been fully restored at treasuries, the use of paper money in the financing of crops like cotton, jute and rice, is becoming very common. The circulation of notes is no longer confined chiefly to large towns and has freely extended to rural areas.[2]

190. War and Currency :—So far we have given an account of the Indian currency system as it developed from stage to stage till the outbreak of the war, with occasional references to the effects it produced upon that system. The war, which threw the world's currencies and exchanges into utter confusion, did not fail to disturb and upset the Indian gold exchange standard. As the question of foreign exchange will be dealt with specifically and in detail in the next Chapter so that it may be adequately treated, we shall here pay it only a passing notice and direct attention to other salient points in the position into which Indian currency was driven by the stress of abnormal circumstances. It is, however, necessary to remark that India's currency difficulties were primarily and directly due to the valuable part the country took in the prosecution of the war and constituted its sacrifice for the Empire and its contribution to the successful termination of the struggle. The first effect of the outbreak of the war was seen in the creation of a panicky atmosphere, the weakening of the exchange, withdrawals of the savings bank deposits, a demand for the encashment of notes and a run on Indian gold stocks. These difficulties were early and courageously met by government, and public confidence was restored in a short time. Had it not been for India's direct and whole-hearted participation in the war, its currency and financial developments would probably have been similar to those in the U. S. A. which remained the only country in the world with a free gold market and with the true gold standard. India's position with respect to the monetary

1 See Report of the Controller of the Currency for 1928-29.

2 "Throughout the Bengal, Madras and Bombay Presidencies notes are accepted freely and their use is extending in Northern India, rupees being preferred only in the remote interior, the frontier districts, hill tracts and the poppy growing districts in the United Provinces."—Report of the Controller of the Currency for 1923-24.

system would have improved and would have been materially strengthened; but the mistaken policy of the Indian Government, as will be clear from the sequel, only made matters worse.

The most serious difficulty government had to encounter was presented by the enormous demand that arose for currency and that could not be satisfied with such large issues of rupees and notes as could be put into circulation. The effects of war conditions began to be seriously felt in the third year of the strife and they steadily grew in intensity. On the one hand, imports into India were curtailed by a shortage of shipping and England's preoccupation in the production of munitions; and on the other, high-priced exports had to be maintained on an extensive scale for supplying the Allied armies with food and war material. Foreign indebtedness to India, due to huge trade balances, could not be adequately met as gold became scarce and the situation was aggravated by the enormous disbursements which the Indian government had to make in this country on behalf of His Majesty's government and repayable in London. The imports of treasure into India were seriously curtailed during the war period; and the natural result of this unsatisfied Indian demand and unliquidated trade balance, was that government had to get hold of all the silver it could and coin it into rupees. The pressure upon the world's silver supplies was intense, and its price steadily rose till at last it attained unprecedented heights, being 89 d. an oz. in 1920. While on the one side, the demand for silver was abnormal, all the world over, the production of that metal averaged 178 million ounces during the four years 1914–17 as against 258 million ounces, the average of the preceding four years. Between April, 1916 and March, 1919, government purchased no less than 300 million standard ounces of silver in the open market besides the 200 million fine ounces out of the metal placed by the U. S. A., under a special agreement, at the disposal of Great Britain. In a memorandum submitted to the Royal Commission on Indian Currency and Finance, 1926, Mr. A. C. Mc Watters gave the following information[1]:—"and on the 23rd April 1918, the U. S. Congress passed the Pittman Act, which authorised the sale to other governments of silver not exceeding 350,000,000 silver dollars from the holding in the dollar reserve. Of this amount

1 Appendices to the Report.

the Government of India acquired 200,000,000 fine ounces at 101½ cents per fine ounce." The following table shows the amount of silver purchased by the Secretary of State :—

	In open market (Standard ounces)	From the U. S. Dollar Reserve (equivalent in Standard ounces)
1915–16 ...	8,636,000 ...	—
1916–17 ...	124,535,000 ...	
1917–18 ...	70,923,000 ...	—
1918–19 ...	106,410,000 ...	152,518,000
1919–20 ...	52,200,000 ...	60,800,000

The average excess of exports over imports in private merchandise during the five years ending in 1914–15 was 72·8 crores ; and it increased to 121·4 crores in the next five years. It was the liquidation of this enormous trade balance that caused an unprecedented demand for internal currency and compelled an excessive expansion of the circulation of rupees and notes. The figures for the absorption of various forms of currency in a series of years, have been already given. It will be seen therefrom that the total currency absorption during the five pre-war years was Rs. 113·1 crores; and the corresponding amount in the three years 1916–17 to 1918–19 alone was 210·3 crores of rupees. In 1914–15, there was a *minus* absorption of 4·2 crores and the figure for the succeeding year was 19·9 crores. The tide of the expansion of currency started in 1917 and the ebb did not set in till 1920–21. These years of storm and stress witnessed the collapse of India's monetary standard; and the attempt of the latter year at rehabilitation did not succeed in restoring it. The exchange standard in this country depended for its success upon government's ability to maintain the artificial value of the rupee and to prevent it from rising above or falling below the fixed rate. The legal ratio between the rupee and sterling was normally kept steady by means of an adequate supply of internal and external currency according to the requirements of trade. On account of the extraordinary conditions mentioned above, government found it impossible, however, to work the system in the normal way. They, therefore, restricted the amount of rupees offered for sale in London, borrowed heavily from the public in this country, watered the currency and controlled the operation of exchange banks which were asked to finance the exports of commodities of

national importance required for the prosecution of the war so as to economise the supply of currency. But the most serious factor which upset the exchange standard was the high price of silver combined with the reduction of gold imports. The bullion par of the rupee, that is, the price at which government can issue rupees to the public on the basis of the fixed ratio of 1 sovereign=15 rupees, without loss, is 44 d. per ounce. This means that if silver rises above this level of sterling price, the 165 grains of pure silver contained in the rupee are worth more than 16d.; and government must either suffer loss in issuing rupees or must demand more in sterling for them.[1] Government was, therefore, driven to the necessity of raising the sterling value of the rupee in successive stages in response to the continued rise in the price of silver.

191. Breakdown of the Standard :—Thus broke down the exchange standard which had been maintained by preventing the rupee from falling below 16d., as soon as the other regulating force which kept the token coin from rising above that level, proved ineffective. Elaborate provision had been made against the fall of the rupee and the system had been successfully tried in times of stress ; but the other contingency that silver would rise to impossible heights had not been contemplated and government's power to secure adequate quantities of silver and to coin them into rupees, had not been doubted. By law the rupee had been made $\frac{1}{15}$th part of the sovereign or equivalent to 7·5 grains of gold, there being about 113 grains of pure gold in a sovereign. But this ratio had to be raised with the rise of silver, and the government's rate of selling rupees by telegraphic transfer was successively enhanced, till it reached 28d. on 12th December, 1919. Besides raising the rate of exchange, government adopted a number of other measures to meet the situation created by dear silver and by the practical cessation of gold imports in liquidation of the trade balance.

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1 The bullion par of a token coin is the value of its metallic contents as distinguished from its face value. This par was 66 d. in the case of the English shilling, 60¾ d. in that of the French five franc piece and 59¼ d. with regard to the U. S. A. dollar. When the gold value of the token coin exceeds the value put upon it, the coin loses its token character and government must either reduce its metallic content or raise its nominal value in response to the rise in the price of the metal. The British government has now reduced the fineness of the shilling and other countries have done likewise to their token currencies.

The nature of the currency malady being known, the remedy was clear, and it was to throw into circulation as much of the media of exchange as could possibly be provided and to prevent these from being wasted by exports, melting or hoarding. As it was now profitable to use silver and gold coins for other than currency purposes, this practice was made illegal on 29th June, 1917; and on 3rd September, the export of silver coin and bullion was prohibited. On 11th July of that year, importation of silver was prohibited except under license and thus competition with government purchase was eliminated.[1] Notes of the denominations of Rs. 2½ and Re 1 were issued with the view to economise silver. With the same object a new two anna nickel piece was issued at the end of March, 1918; and in September, 1919, authority was taken from the legislature for the coinage of four and eight anna nickel pieces.[2] The latter were not to be unlimited legal tender like the silver half-rupees and the limit was put at one rupee. To make up for the shortage of silver, government issued an ordinance in June, 1917 and tried to increase its holding of gold by requiring all gold imported into the country to be sold to it at a rate fixed from time to time and based upon the sterling exchange value of the rupee and irrespective of the prevailing premium on gold as compared with sterling and of the existing legal parity between the rupee and the sovereign. To relieve the strain on the silver balances, Rs.11·66 crores worth of currency sovereigns were issued to facilitate the finance of the wheat and cotton crops, but the bulk of the gold coins found their way to the melting pot or to private hoards. The price of sovereigns in the course of the year 1917–18, fluctuated between a minimum of Rs. 15–3–3 and a maximum of Rs. 18–4–0.

To supplement the rupee and paper currency a branch of the Royal Mint was opened in Bombay in August, 1918; and as some delay was inevitable before sovereigns could be minted there, a gold Mohur of the same weight and fineness as the sovereign, was issued. In April and May of 1918, a grave currency crisis seemed imminent

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1 There was profit in these transactions and all kinds of ingenious artifices were employed to secure it. Before the second of the above two prohibitory measures was taken, particularly the despatch of sliver by rail and post, at one time at Bombay there were actually no fewer than 8 tons of silver parcels awaiting despatch.

2 These were withdrawn and ceased to be coined a few years later.

and government escaped from inconvertibility by the skin of its teeth. The demand for silver currency was large and insistent, and its stock with government was as rapidly exhausted as it was replenished.[1] On 20th May, the despatch of specie by rail on private account was prohibited and this measure was followed shortly afterwards by the prohibition of transmission of specie by post. Supplies of silver ran short, and the new rupee coinage and the absorption of rupees in 1918–19 were Rs. 50·7 and 45 crores respectively. The silver supplied by the government of the U. S. A. under the Pittman Act was of the greatest use in the crisis. The keen demand for currency in India need cause no amazement. For four years prior to 1919 the imports of the precious metals on private account were prohibited or restricted and were, in consequence, abnormally low, and the void created was being filled up by the absorption of currency. It is necessary to bear in mind here that though the total absorption of the precious metals in the forms of coin and bullion was heavy in the years 1916–17 to 1918–19, it was by no means larger than in 1911–12 and 1912–13, and this will be evident from the following figures:—

	Private net Imports of gold coin and bullion	Private net Imports of silver coin and bullion	Absorption of Rupees.	Total Absorption.
1911–12	37·7	5·2	11·5	56·6
1912–13	37·5	6·5	10·4	54·6
1913–14	23·3	6·2	5·3	34·8
1914–15	8·4	10·0	–6·7	11·7
1915–16	4·9	5·5	10·4	20·8
1916–17	4·2	–2·1	33·8	35·8
1917–18	·0	1·4	27·8	32·4
1918–19	·02	·06	45·0	45·1

1 New rupee coinage amounted to Rs. 29·9,23·1,50·7 and 37·3 crores during the years 1916–17 to 1919–20. The largest quantity of new rupee coinage in any month, was 8·3 crores in December, 1918; and the heaviest absorption was 6·8 crores in April of the same year. "The combined value of the two Indian Mints' output in August, 1918, was Rs. 5½ crores. As the average speed of coinage is estimated at 2,600 coins a minute in Calcutta and 1,660 in Bombay, the velocity of the output per second equals 70 coins worth an average value of 46 rupees. If the pieces coined during the month alone at this rate were placed edge to edge the line would stretch across a space to the extreme length of India—from the Hindu Kush to Cape Comorin."—Samuel Montagu & Co.'s Bullion Letter.

Before gold coinage was suspended in April, 1919, 2,110,000 Mohors and 1,295,000 sovereigns had been coined in Bombay. On account of the premium upon gold in the bazar, the sovereign selling at as much Rs. 19, gold coins hardly circulated as currency, though in 1917 and in 1918, government issued sovereigns and mohors amounting in value altogether to £ 11 million. In order to supply to the public the gold for which there was an exceptionally keen demand, government commenced, at the end of August, 1919, fortnightly sales of that metal and succeeded in bringing down its price to an appreciable extent. These sales were continued into the next year with the view to adjust the price of gold to the new ratio adopted on the recommendation of the Babington Smith Committee.

192. Babington Smith Committee:—It was no defence of the exchange standard to say that under it, government was at liberty to raise the value of the rupee as circumstances required, because that value had been fixed as that of so many grains of gold, the rupee being regarded, for all practical purposes, as a bit of gold and not of silver. It may be urged that the gold standard in Great Britain and in other countries did not fare better than the Indian system : but that is a different matter altogether. The chaotic condition of the system of currency and exchange in India at last appeared to call for an inquiry and a suitable remedy. On 30th May, 1919, the Secretary of State, therefore, appointed a committee with Sir Henry Babington Smith as chairman, and its report was published early in February, 1920. The Committee was asked to examine the effect of the war on the Indian exchange and currency system and practice and upon the position of the note issue and to make recommendations as to modifications that might be thought necessary " with the view to ensuring a stable gold exchange standard". The question of monetary standard was not kept open because the maintenance of the exchange standard in the future was assumed, and the discussion of the problem of the establishment of a true gold standard was not to be revived. What was desired was the stabilizing of the exchange value of the rupee (which, in effect, meant the standard quantity of gold), at a suitable rate with due regard to the economic conditions which had developed themselves in India and outside during the war period.

The Committee attached the greatest importance to the stability of the value of the rupee and thought that if a large change had

taken place in it already, 'it may be preferable to establish stability at the new level rather than to submit to the further change which is necessary for a return to the old level, especially if the former course shortens the period of uncertainty.' The alternative courses open if the rupee was not to be fixed at a high sterling rate, would have been (1) a reduction of the fineness or weight (or both) of the rupee, (2) the issue of 2 or 3 rupee coins of lower proportional silver content, (3) the issue of a nickel rupee, or (4) temporary and partial inconvertibility of the note issue. The Committee rejected all these suggestions on the ground that the rupee, with which the masses had become so intimately familiar, and to which they were, so to say, deeply attached, must, in no case, be tampered with; and as regards inconvertibility, temporary or otherwise, it was simply unthinkable. There were really two courses open. Either the old monetary standard must be maintained and the rupee adjusted to it; or the rupee must be kept intact and the standard itself must be changed. The Committee and the government preferred the latter course, and in effect, altered the Indian monetary standard. It was a confession, conscious or unconscious, that the exchange standard had failed. A consideration of vital economic importance which carried great weight with both was the prevalence of high prices outside India and to a smaller extent in this country. A high rate of exchange was regarded as an effective remedy against the impending equalization of internal with external prices.[1]

The most suitable rate of exchange was, in the opinion of the Committee, 24d. and it was to be expressed not in terms of sterling but in terms of gold. That is to say, the rupee was to be linked to gold and not to the pound sterling. Gold coin was not in circulation in England and Treasury notes formed the great bulk of the full legal tender currency and these were not convertible into gold. The pound sterling was, therefore, at a discount.[2] The American dollar was convertible into gold and New

1 This will be explained in the next chapter.

2 "The result is that there is a divergence between the value of the pound sterling and the sovereign. One hundred ounces of fine gold come to be coined into 425 sovereigns, but at the quotation on 17th December, (108 s. 9 d. per oz.) 100 ounces of fine gold cost approximately £ 544 in sterling i. e. in notes. Thus £ 1 sterling (paper) is equivalent to 425/544 or ·78 of the sovereign (gold), a discount of 22 per cent.; or conversely, the sovereign (gold) is worth £544/425 or £ 1·28 sterling (paper,) a premium of 28 per cent."—Report of Babington Smith Committee, paragraph 55.

York was the only free market for gold. The relation between the gold sovereign and the gold dollar is the relation between the quantities of the metal contained in the two coins and it is expressed by saying that one sovereign= 4·8666 dollars. But in December, 1919, the pound sterling was quoted at £ 3·83, which meant a depreciation of 21 per cent. The discount on the British currency continued, though on a slightly smaller scale, till the middle of 1925 when the gold standard was restored in England with important reservations. In view of this depreciation and fluctuation in the value of sterling, the Committee recommended that the rupee should be linked to gold and not to sterling. The stable relation between the rupee and gold was fixed at the rate of Rs. 10 to the sovereign or of one rupee for 11·30016 grains of fine gold. What was India's legal exchange standard ? The equivalence of the rupee to $\frac{113}{15}$ or about $7\frac{1}{2}$ grains of fine gold. The high price of silver now rendered this relation impossible, and consequently a higher gold value was attributed to the rupee ; and the old standard was radically altered, being raised from $7\frac{1}{2}$ to $11\frac{1}{3}$ grains of gold per rupee. There was no question of principle involved in the Committe's recommendation regarding the linking up of the rupee to gold instead of to sterling, as the Indian standard had been a gold and not a sterling standard, the rupee being equivalent to so many grains of gold. As to the practical aspect of the recommendation, experience soon proved how futile were the efforts to maintain the distinction.

Having altered the ideal gold value of the rupee from one-fifteenth to one-tenth part of a sovereign and rendered it independent of the depreciation of the pound sterling, the Committee proceeded to make other recommendations. It wished that the import and export of gold into and from India should be free from government control and reiterated the opinion of the Chamberlain Commission that though the aim of currency policy should be to give to the people the form of currency they demand, 'gold can be employed to the best advantage in the government reserves where it is available for meeting the demand for foreign remittance.' But in order to relieve the prevailing monetary stringency and also to continue the practice of partly meeting the normal gold demand of certain parts of India, the Bombay branch of the Royal Mint was to be reopened for the coinage of sovereigns or an Indian gold mint was to be established to issue mohurs, and the obligation of government

to give rupees for sovereigns was to be withdrawn in view of the prevailing shortage of silver, though in normal times facilities were to be given for the conversion of legal tender gold into the legal tender silver coin and *vice versa*. The public was, of course, to be given opportunities to exchange sovereigns in their possession at the rate of Rs. 15 per sovereign at the time of the introduction of the new ratio. It was further recommended that the prohibition on the private import and export of silver should be removed in due course and that the import duty on silver should be repealed unless the fiscal position demanded its retention. The suggestion which had been placed before it in favour of a modification in the practice of purchasing silver for coinage and of arranging for its purchases in Bombay, which has a large bullion market, to the benefit of the government and the advantage of Indian dealers, did not commend itself to the Committee who refused to make any recommendations in that behalf. The Committee made important suggestions regarding the Paper Currency and Gold Standard Reserves which have been already alluded to. The higher rate of exchange would necessitate the revaluation of sterling investments and gold in the Reserve at 2 s. to the rupee, and the loss due to depreciation resulting from this operation, it was suggested, could be made good from savings accruing from the rise in exchange, in a limited number of years.

193. Criticism :—It will be seen that several of the recommendations of the Babington Smith Committee were designed to readjust the Indian currency system consistently with the maintenance of the exchange standard and were incidentally calculated to meet the wishes of the critics of government's currency policy in certain respects. The Indian monetary standard had, in fact, become a hybrid. A free gold mint was incompatible with the exchange standard, and if one was to be permanently established there was no point in refusing to develop a true gold standard in the country. Leaving the question of the high rate of exchange to be discussed in the next Chapter, we may here say that the alteration of India's monetary standard by the executive action of government and the general working of the gold exchange standard during and after the war, had caused deep and widespread dissatisfaction in the country. Mr. Dalal, the only Indian member of the Babington Smith Committee, could not agree with his colleagues on the funda-

mental questions at issue. He strongly protested against the change in India's money standard[1] which was the legal ratio ot 1 : 15 between the sovereign and the rupee, and he characterised the change as "a veritable revolution in her currency arrangements which must cause a widespread and lasting hardship amongst the masses of the people of India." He, therefore, recommended that "the money standard in India should remain unaltered, that is, the standard of the sovereign and the gold mohur, with rupees related thereto at the ratio of 15 to 1."

Mr. Dalal further stated that it was not also necessary to alter the currency standard and that the high price of silver was not a sufficient justification therefor. He thought that the large demand for currency in India was caused mainly 'by the acceptance in London of payments due to India in the form of sterling which could not be transmitted to India by the usual methods.' The indebtedness of foreign nations to India could have been liquidated by the floatation of loans by them here if the import of the precious metals was impracticable. Great Britain paid for U. S. A. imports by the export of gold and of American securities held by British citizens and also by floating loans in America. The same procedure could have been followed with reference to India's favourable trade balance.[2] But no such steps were thought of and the action of the Indian government in prohibiting the exports of silver, the exclusion of the Indian stocks of that metal from the world's markets and the enhancement of the rate of exchange, drove silver prices to high levels. The mere fact of India selling her silver would, in Mr. Dalal's opinion, have shaken the strength of the silver market; and the sale of its silver currency by the government of the U. S. A. in similar circumstances, lends support to his contention.

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1 "In contradistinction to this legally established standard, the gold exchange standard has no validity. It has not been clearly and explicitly defined. The authorities who conduct it, exercise the widest discretion in its regulation but hitherto have been careful to respect the legally constituted ratio between rupees and the sovereign."

2 "Still there is little room for doubt that, during the war, British Government loans could have been successfully floated in India on a very large scale on the same lines and terms as some of those publicly floated in the U. S. A. to meet the expenditure of the Imperial Government."

The minority report of Mr. Dalal anticipated and echoed the views of the critics of the exchange and currency policy of government in India when he asserted : "India is fairly entitled to a system of sound money. The gold exchange standard has failed to provide such a system, and I am unable to make any recommendations for its continuance which would secure the stability it has lost. I consider that the authorities had no right to take the action of raising the rate of exchange and, in my opinion, it is their duty to proceed to undo what they have done." The Committee had indeed an exceedingly difficult task set to it. Economic conditions all the world over were so uncertain that a forecast of the developments even of the near future was surrounded with risk. It based its conclusions on the probability of world prices remaining high and was careful to state that "if contrary to expectation, a great and rapid fall in world prices were to take place, and if the costs of production in India failed to adjust themselves with equal rapidity to the lower level of prices, then it might be necessary to consider the problem afresh." Mr. Dalal's remedy was the free coinage of gold Mohurs for the public, the minting of a new coin with the face value of Rs. 2 and containing silver of reduced fineness as compared with that of the existing rupee so long as the price of silver was over 92 cents and the issue of a new 8 anna silver piece of reduced fineness to be full legal tender.

The extraordinarily high prices of silver threatened the token currencies in England, France and other countries, and their governments met the emergency by issuing notes of small denominations and by preparing to debase the silver coins or to manufacture new coins. It had been proposed, and the proposal was approved by Mr. Dalal, that on the above lines, while the existing silver rupee of 165 grains of fine silver should be continued full legal tender, its further coinage should be stopped and as long as silver prices ruled high, rendering the bullion value of the rupee higher than its face value, government should issue 2 rupee silver coins of reduced fineness as legal tender, making it impossible for the new currency to go to the melting pot. If the choice lies between altering the standard of value and the metallic contents of a token coin, the latter alternative is certainly preferable, because it is less radical and disturbing in its effect. And this method has been followed in several countries during and after the

war. The rupee is, after all, a token coin and a change in its silver content would not have been a serious matter. But the government was overwhelmed with apprehensions regarding the political and social effects of the measure ; and the Committee on Currency and Exchange regarded the weight of its opinion as decisive. The objection was certainly not entirely baseless and the adoption of the measure, often erroneously characterised as 'debasement' was surrounded with administrative difficulties, particularly the prospect of the new coin driving the full-weight rupee out of circulation. But as a matter of fact, government, which faced worse difficulties and would, at one time, have taken the risk even of inconvertibility of its notes, need not have shied at the proposal to issue a new token coin, if it could have saved the country's monetary standard thereby.

194. Readjustment:—We shall now bring up to date the narrative of the general development of the currency system during the six years following the publication of the report of the Babington Smith Committee and government's acceptance of its principal recommendations. At the beginning of the official year 1920–21, the restrictions on the import of gold bullion and coin were in operation. All imported gold was acquired by government, and the acquisition rate was altered on 2nd February, 1920, to Re. 1 for 11·30016 grains of fine gold. The sovereign, however, provisionally remained legal tender for Rs. 15, restrictions on the import of gold bullion and foreign coin were removed on 21st June, and by an ordinance of the same date, Ordinance No. III, gold coins referred to in section 11 of the Indian Coinage Act (III of 1906), ceased to be legal tender. Sovereigns were to be accepted at the old rate by government during a moratorium of 21 days, on the expiry of which the restrictions over the import of British gold coins were also removed. The total amount of sovereigns received at currency offices and treasuries, was £ 2½ millions. All these measures were preliminaries to the adoption of the new ratio of the rupee and the sovereign, 10 to 1, recommended by the Currency Committee. Legal effect was given to that recommendation by the Indian Coinage (Amendment) Act, No. XXXVI of 1920 which received the assent of the Governor General on 9th September, 1920. The legal tender character of the sovereign and the half-sovereign, suspended by the Gold Ordinance of 20th June, 1920, was thus restored by law: the market price of the gold coins was another matter.

Since September, 1919, government had been selling to the public, gold purchased in London, and also acquired in India. The sales were intended to reduce the premium on gold that prevailed in the country and to help the establishment of the new ratio which required cheap gold, at Rs. 16 per Tola, and likewise to support exchange by reducing gold imports. Owing to various restrictions on the free movements of gold in this country and outside, its price in 1918 and in the early part of 1919, was unusually high, standing at Rs. 32 per Tola in August of that year. In the mean time, however, the American embargo on gold was removed and the market for South African and Australian gold was freed. This opportunity was availed of to purchase large quantities of the metal for India, and the purchases assisted the transfer of Indian funds accumulating in London to this country and the cheapening of gold in the market here. There were 13 sales of gold between September and the close of March; and the total quantity sold was 90,59,710 tolas. The price of the metal was brought down by this means from Rs. 28 to Rs. 22-13. The sale of gold had the effect of reducing the demand for currency and the circulation of notes. There were 12 more sales between April and September of 1920, and the total amount of gold taken up by the public was 1,25,29,925 tolas. The cessation of sales in October pushed up the price of gold steadily and it stood at Rs. 30 per Tola on 31st March, 1921. In the absence of other favourable factors, this measure thus failed to lower the price of gold and to help in the establishment of the new monetary standard. In the course of the year 1920-21, all the remaining restrictions on the movements of the precious metals necessitated by the extraordinary circumstances of 1918, were removed, and the recommendations of the Currency Committee in that behalf were carried out. The restriction imposed on the transit of silver by rail and boat was taken away on 18th June, 1920; and on 20th July, was cancelled the prohibition on the export of silver, imposed in September, 1917.

In September, 1919, owing to difficulties in the ways and means position, legal powers had been taken by Act XXVI of 1919 temporarily to increase the permissible holdings of securities in the Paper Currency Reserve to Rs. 120 crores, of which Rs. 100 crores were to be held in British Treasury Bills. Owing to the heavy sales of reverse councils, the Secretary of State had to dispose of a portion of the sterling securities in the Reserve, and in the absence

of permission to increase investments in Indian securities, it would have been necessary to cancel notes in this country to the full rupee equivalent of the sterling securities sold. It was thought that this proceeding would cause a serious monetary crisis in India, and Act No. XXI of 1920 was passed in March to remain in force till 1st October of the year, continuing the existing figure of 120 crores as the limit of permissible investment but abolishing the restrictions as regards the locale of the securities and their sterling or rupee character. The above mentioned Act was replaced by Act No. XLV of 1920 which came into force on 1st October. The latter gave effect to the recommendation of the Currency Committee regarding the constitution of the Currency Reserve, while providing for a period of transition. The gold and the sterling securities held in the Reserve were revalued on 1st October at the rate of Rs. 10 per sovereign, and the deficiency resulting from the revaluation was made up by 12 months' Treasury Bills of the Government of India issued by the Controller of Currency to the Reserve. It was proposed to utilise the interest on the security reserve to wipe off the 'created' securities, and therefore, the above loss, but effect was not given to the proposal. The composition of the Reserve, assumed a radically altered form towards the close of 1920-21 as compared with what it was a year before, as a result of government's effort to maintain exchange at a high level[1] and of the changes mentioned above. On 31st March, 1920, the securities held in England and India were worth respectively 67.6 and 19.5 crores; and a year later they were valued at 8.9 and 68.0 crores respectively.[2] The gold holding had been reduced in the year by 20 crores and the silver holding had increased by 28 crores.

1 These exchange and remittance operations will be explained at length in the next chapter.

2 "In 1919-20 and 1920-21 the total amount of Reverse Councils sold was £ 55,532,000. The entire amount was in the first place, met from the Secretary of State's treasury balance and the sale proceeds of the bills were credited to the treasury balance in India. Between March and October, 1920, however, the Secretary of State drew £ 46,650,000 from the Paper Currency Reserve in England and the withdrawal of this amount would have involved a contraction of the currency in India to the extent of Rs 68:73 crores if the Government of India had not issued *ad hoc* treasury bills to the Paper Currency Reserve in India to the exten of Rs. 34·05 crores".—Hilton Young Commission's Report, Appendices.

195. 'Wait and See' Policy :—The pressing appeals made to government so early as in 1921 that it should cause another inquiry to be made into the currency and exchange situation and that it should retrace its foot-steps to the position occupied before the last investigation, is an instructive commentary on the measures taken by the State in connection therewith and the course which events followed. Government miscalculated the effects of the policy it adopted ; its forecast of the immediate economic and financial future of India and of the world, went hopelessly wrong ; the assumptions underlying the recommendations of the Currrency Committee were not satisfied ; and yet having once started on the path chalked out by itself, government persisted in its march in spite of warnings and protests till at last the finances and the currency system of the country were thrown into utter confusion and a dead halt had to be called. "Wait and see", then became the motto of official declarations. After the exchange was left to take care of itself when the new ratio of 1 : 10 could not be maintained, in spite of frantic efforts and heavy losses, what was the monetary standard of India? Legally, it was $11\frac{1}{3}$ grains of pure gold giving a ratio of Rs 10= 1 sovereign in gold, that is, 24 d. gold. But the market rate was, for months, $15\frac{1}{2}$ d. sterling per rupee and afterwards settled down in the neighbourhood of 18 d. The standard, therefore, was not a quantity of gold or sterling ; it was not also gold exchange. There was practically no monetary standard ; and the value of the rupee in sterling fluctuated for a long time with the sterling price of silver and then with the currents of foreign trade. In and after 1922–23, the relation between the price of silver and the exchange value of the rupee ceased. The idea of fixing the value of the rupee at a certain level and maintaining it there was, for the time being, abandoned, and thus the gold exchange standard was given the go-bye. The policy of the near future was made to depend, apparently, on the anticipated recovery of the export trade and the rise of the rupee with the increased demand for currency. But was it to be fixed at 16 d. or at 24 d.? (The most likely rate was 18 d.—a level at which the rupee had stood for nearly two years). Should the exchange standard be restored or ought a full gold standard be established ? Another commission of inquiry was expected to answer these questions ; and the cold logic of events, as they occurred, was to be the determining force. Having had their fingers once burnt, government became extremely cautious and waited for a decidedly favourable turn of events.

The years 1924 and 1925 were a period of masterly inactivity in affairs relating to the national currency. Government recognised that a balanced budget was a condition precedent to the rehabilitation of the normal system, and maintained that the task could not be successfully achieved until the general economic situation in the world had undergone material improvement. The 2 shillings gold ratio appeared to be hopeless and a return to 16 d. was considered impracticable and undesirable. Steps were taken early in 1925 to relieve seasonal monetary stringency by an amendment of the temporary provision of section 19 of the Paper Currency Act of 1923 so as to raise the permissible investment of the Reserve from Rs. 85 crores to 100 crores and thus with a corresponding addition to paper currency, to prevent the rate of exchange from rising above 18 d. Commercial opinion in Bombay pressed for the restoration by law of the old currency ratio but the Finance Member, Sir Basil Blacket, was adamant. He maintained that India had been saved from the disaster of high prices by a high rate of exchange and that the 18 d. rate, which had prevailed for months, was disadvantageous to none, either producer, consumer or taxpayer, whereas the restoration of the old ratio would result in inflation of currency. Large quantities of gold that were coming into the country, were going into the hoards as they could not be turned into currency so long as the ineffective ratio of 2 shillings stood on the statute book. The Finance Member stated that monetary stringency was being effectively met and that he did not believe in a gold currency but softened to this extent that he declared in favour of taking the Indian currency system nearer to the real gold standard than had been the case before the war, and his government expressed its readiness to appoint a commission to inquire into the whole exchange and currency problem before the end of the year. In the opinion of several thinkers the time was opportune, when Great Britain and other countries had gone back to the gold standard, for India to adopt a full fledged gold standard system instead of tinkering with the rate of the rupee-sterling exchange. Bills were actually drafted as models for currency legislation, and they provided for currency notes based on gold, for a gold mint and for a limited legal tender rupee—in fact, for all the characteristic features of a gold standard as distinguished from a gold exchange standard. Some of the proposals stopped short at the restoration of the old ratio and others provided for a transitional stage.

196. Hilton Young Commission :—By August, 1925 it had come to be believed that an inquiry into the currency system of India would be justified by the steady improvement taking place in the economic and monetary situation in the world and particularly by the restoration of sterling to parity with gold in the middle of 1925 ; and the Royal Commission presided over by Lt. Commander Hilton Young was appointed. It had to define the currency standard for India, suggest the authority that should control the currency and propose a suitable rate for the stabilization of the rupee. We shall restrict ourselves here to the consideration of the recommendations and arguments of the Commission only in so far as they relate to the subject matter of this chapter. During the four years preceding this inquiry, India had practically no monetary standard ; such as it had according to law, was ineffective and the executive government had been working up to a new one, upon which it had apparently set its heart. The value of the token currency, both silver and paper, was being maintained between the gold points corresponding to a gold parity of 1s. 6d., and gold currency was not in circulation. Without assuming any positive authority in that behalf, and as currency authority, government was freely purchasing sterling when the rate stood at 1s. 6 $\frac{3}{16}$d. and authorised the Imperial Bank to sell sterling at 1s. 5$\frac{3}{4}$d. There was no statutory basis for this rate and consequently for the monetary standard it constituted.[1]

A careful examination of the currency system revealed to the Commission the following grave defects:—(1) "The system is far from simple, and the basis of the stability of the rupee is not readily intelligible, to the uninstructed public." (2) "There is a cumbrous duplication of reserves, with an antiquated, and dangerous, division of responsibility for the control of credit and currency policy." (3) "The system does not secure the automatic expansion and contraction of currency. Such movements are wholly dependent on the will of the currency authority." (4) "The system is inelastic." The condemnation of the Indian currency system, so much eulogized, could not

1 "The stability of the gold value of the rupee is thus based upon nothing more substantial than a policy of the government, and at present that policy can be found defined in no notification or undertaking by government. It has to be implied from acts of the government in relation to the currency, and those acts are subject to no statutory regulation or control."—Hilton Young Commission.

have been stronger, and it was obviously necessary to alter it radically. The Commission examined three alternative methods of reform, viz. (1) the perfection of the sterling exchange standard, (2) the adoption of a gold exchange standard and (3) the adoption of a gold standard proper, with or without a gold currency, and rejected the first two as defective and undesirable, giving its preference to the third. Apart from the technical difficulty created by the price of silver rising above the melting point of the rupee, combined with the obligation to redeem paper money in silver coins, the Commission thought that the chief defect of the exchange standard was that 'although it secures stability, it has not the simplicity which is essential to secure the confidence of public opinion for any currency system under present conditions in India' and thus it laid its finger on one of the weakest spots in the system. The Commission very wisely did not ignore the fact that there was a large body of public opinion in India which was suspicious of the mechanism of the exchange standard, however refined it might be, and felt convinced that it could be manipulated and handled in a manner not consistent with Indian interest.

This avowal on the part of the Commission vindicated the attitude of the opponents of Government's currency policy and evinced a correct appreciation of the danger of seeking to introduce and establish in India economic systems ill-suited to the sentiment of the people and to the political and social conditions prevailing in the country. The Commission did not, however, pursue its thesis to its logical conclusion and disapproved a scheme presented by the Finance Department of the Government of India, providing for the cautious introduction of a gold coin and gold notes. In his memorandum submitted to the Commission, Mr. Denning, Controller of Currency, reviewed the defects of the exchange standard, and while admitting that 'the ideal to be aimed at is the system now in force in Great Britain under which the note is the sole full legal tender in circulation and the gold value of sterling is stabilised by the statutory obligation imposed on the Bank of England to buy and sell gold at a ratio corresponding roughly to the par of exchange,' he deliberately concluded that the only way of remedying the defects in the Indian system within a reasonable period was "by establishing a gold standard with a gold currency in circulation."[1]

1 Report of the Commission: Appendices.

Sir Basil Blacket similarly expressed a favourable disposition towards a full gold standard. The Commission, however, objected to the scheme on the grounds of (1) the adverse effect of India's anticipated absorption of about £ 103 million of gold (in addition to normal absorption for the arts) on credit, rates of interest and gold prices throughout the world, (2) the unreliability of the estimates of the amount of gold required and the time at which it would be required, (3) the disturbing and detrimental effect likely to be produced on the silver market of the world, (4) the loss in silver value that would be imposed on the masses in India, (5) the probable undesirable effect on India of the reaction of the scheme on China and other silver using countries and (6) the improbability of British and American co-operation being secured for the carrying through of the plan. The Commission felt that these objections were decisive against the proposals and that their main object, viz. educating the public in the habits of banking and investment, was not likely to be achieved through the introduction of a gold currency.

197. Gold Bullion Standard :—If the Commission agreed that the exchange standard suffered from serious drawbacks and believed that the introduction of a gold currency was both impracticable and undesirable, how did it propose to link the Indian currency with gold and inspire confidence in the public mind with respect to it? It fell back upon the principle underlying the Lindsay and Probyn schemes referred to on a previous page[1] and provided for gold bullion being purchased and sold by the Indian currency authority instead of gold coins being received and supplied. It eliminated the gold coin altogether from its own scheme, the sovereign itself being demonetised, and proposed to maintain the relation between the rupee and gold by means of the link of purchase and sale of gold bullion at fixed prices. This was thus a half way house between the gold exchange standard and the gold currency standard and was appropriately called the 'gold bullion standard'. The Commission thought that this scheme represented an absolute gold standard as under it gold bars were to be given not for export only but for any purpose, and the compensatory mechanism of the exchanges was preserved because gold bars were not currency. When gold bars were given to the public in exchange

1 · See page 496 above.

for rupees and notes, the circulation of currency would be contracted; and expansion of currency would be secured when gold bars tendered by the public to the currency authority are exchanged by it, for notes or rupees. The convertibility of the rupee and paper currency into actual gold being guaranteed it was believed that the confidence of the public would be enlisted and the temptation to hoarding would be successfully checked while the issue and circulation of gold coins were calculated to cause an unnecesssary waste of the yellow metal to the serious disadvantage of western nations without assisting the maintenance of the Indian exchange ratio.[1] The obligation to buy and sell gold at the par of exchange, would, however, involve the currency authority in the difficult task of providing gold at unfavourable prices for non-monetary as well as monetary purposes. It was, therefore, suggested that the buying and selling rates should be so fixed as to discourage the public from resorting to the currency authority for the supply of gold for other than the purely monetary purpose. The gold bullion standard recommended by the Commission and adopted by Government, rested on the relation of internal currency to gold corresponding to the ratio Re.1=18d. or 8·47511 grains of gold for one rupee. The Indian monetary standard was thus legally changed once more as it had been done before on the recommendation of the Babington Smith Committee.

The Commission did not fail to perceive that in the absence of a gold currency the public at large would be far from able to see the tangible link between the gold standard and the silver and paper currency, and it had consequently "to find some further and more direct and visible means for bringing it home to the masses that gold is the standard of value of the rupee and that the one is convertible into the other." Such a means was to be "the offer by the government "on tap" of savings certificates, redeemable in three or five years, in legal tender money or gold at the option of the holder." These were proposed to be issued in denominations of one tola and integral numbers of tolas, and sold for legal tender money, at a price

1 "For the purposes of India this standard fulfils the essential condition that it should be not stable only, but simple and certain. It provides the token currency with a right of convertibility that is intelligible to the uninstructed, and with a backing that is tangible and visible. In short it has the characteristics necessary to inspire confidence in the Indian people".—Report.

which would give the holder an attractive yield in interest. The Commission discounted the fear that was expressed in this regard that the certificates would have the undesirable effect of stimulating a fresh demand for gold by the observation that on the contrary the offer of the certificates would constitute a powerful incentive to investment and an effective antidote to hoarding. The scheme propounded by the Commission necessitated the establishment of a Reserve Bank that would perform the functions of a central bank, corresponding to those performed by similar institutions in western countries. Government would thus be freed from its currency responsibilities as well as the partial obligation in relation to control of credit; and a unity of policy in both respects would be ensured by a banking institution taking over duties which a government is ill-fitted efficiently to discharge.

198. Radical Changes:—The Reserve Bank was to have the sole right of note issue, and in a few years Government notes were to cease to be legal tender except at Government Treasuries. The notes of the Bank were to be full legal tender and were to be guaranteed by government. As it was intended to assign to the rupee a subordinate position ultimately, the legal obligation to convert paper currency into silver coin was to be withdrawn though facilities were to be given for the free interchangeability of the different forms of legal tender currency. One rupee notes were to be reintroduced and made full legal tender. While the legal tender character of the silver rupee was not to be changed, notes other than the one rupee note would be legally convertible into notes of smaller denominations or silver coin at the option of the currency authority. The Paper Currency and Gold Standard Reserves would be amalgamated and the proportions and composition of the combined Reserve would be fixed by statute. The "proportional reserve" system was to be adopted and the silver holding would be substantially reduced in the course of ten years. It will be seen from the above description of the new system proposed by the Hilton Young Commission that it was intended to approximate to the system of central banking prevalent in western countries. Owing to the effects of the war, European nations were compelled to adopt a gold bullion standard, at least for the time being; and it was anxious to conserve the available gold resources of the world which were to be used through central banks to support national currencies and were to be prevent-

ed from being dissipated in the form of gold currency. It was believed that there would be a disastrous fall in prices, involving industries in ruin, if the supply of gold for monetary purposes fell short of the demand, and the danger was apprehended that if India was permitted to have a gold currency, this result would inevitably take place.

The Hilton Young Commission was strongly influenced by the apprehended serious situation of the western world which was engaged in the task of economic and monetary rehabilitation, and though it observed that public confidence was the essential condition of the success of a currency system, it stopped short of recommending the issue of a gold coin in India. In this respect it shared the views of its two immediate predecessors and of western financiers generally, and could not enter into the spirit of the wishes and the needs of the Indian public. Its attitude was more cosmopolitan and non-Indian than national and Indian. From the point of view of pure theory, even a paper standard is unobjectionable, and a bullion standard stands nearer to a gold currency standard. But it is practical considerations that ought mainly to count here, and that is why departmental opinion in the Indian government favoured a gold currency. The difficulties surrounding the introduction of a gold coin, including the one relating to its cost, were exaggerated by the Commission, and the possibility of the carrying through of a cautious scheme was scouted. The repercussions on India of an inadequate supply of gold in western countries caused by the circulation of gold coins here, certainly deserved consideration; but the self-denying ordinance imposed on India in this respect was not indispensable. The view of the future of world supplies of gold taken, was unnecessarily too gloomy, and in any case, opinion on this subject is not unanimous. It is probable that nations like England will return to the full gold standard in the near future, and it is unfortunate that the opportunity to introduce that system here should have been allowed to pass by. It is feared that the drawbacks of the exchange standard will characterise the working of the bullion standard also, and the mistake now committed may be discovered in a few years when it may be difficult to correct it. Indian public opinion did not, therefore, accept the recommendation of the Commission in this regard, but the Government of India was converted to the views of the latter and the

legislature was asked to give effect to them. Gold was thus demonetised and preparations were made to inaugurate the Reserve Bank which was to control currency and the Reserves. The latter scheme was, however, rejected by the legislature, and a gold exchange standard at 18d. per Rupee, was put in operation. The position was, therefore, of a stand-still, except that government sold quantities of surplus silver in the Currency Reserve to maintain the new exchange ratio, and nothing further was done in furtherance of the policy recommended by the Currency Commission. Only a central banking inquiry committee was appointed in 1929, with provincial committees, to investigate the problem of banking organization in the country. More recent changes in connection with rupee and paper currency as also the composition and the size of the Currency Reserve, will be conveniently described in the following chapter as they are intimately bound up with exchange policy.

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CHAPTER XII.

FOREIGN EXCHANGE AND FINANCE.

199. Mechanism of Exchange :—If full payment in money or gold or silver bullion was to be made to foreign countries for commodities imported from them and if they were expected to make similar remittances for articles exported to them, it would be a troublesome, inconvenient and wasteful proceeding, calculated to hamper trade seriously. The paper money of one country will obviously not be accepted for payments of debts in another. Even metallic money will be taken outside a country only at its bullion value.[1] On account of their universal acceptability, the precious metals will, therefore, have to pass to and fro between nations to settle their claims on one another. But the trouble is avoided and the expense is saved by the mechanism of bills of exchange which enable international indebtedness to be adjusted very easily. Importers who have to make remittances abroad, purchase export bills (which are, in effect, claims to receive foreign money, and are orders issued to their customers by exporters of commodities to foreign countries), and send them to their creditors who realise the money from people on whom the bills are drawn and who are themselves saved the trouble of making remittances to their own creditors. If a balance of indebtedness remains between countries after such adjustment has taken place, gold or silver may be remitted to make up the amount. The exports of a country are said to pay for its imports and the trade is stated to be nothing but barter, commodities being exchanged for one another by the trading communities. This is perfectly true so far as the ultimate analysis of international trade is concerned. But trade is carried on by individuals and firms and they do not directly exchange commodities for commodities. Exports and imports of goods are specialized transactions and have to be separately paid for. But taking a country as a whole, we can speak of its

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1 The rare case of money like the sovereign, which was legal tender both in Great Britain and in India until lately, is an exception.

balance of trade as its exporters and importers settle their claims and obligations by the mechanism of exchange described above.

International, as well as internal trade, is facilitated by dealings in claims for the payment of the values of goods, which sellers have on buyers. Payment of the value of commodities purchased may be made as much by transferring to the seller claims to money as by the direct handing over to him of the precious metals, coined or otherwise. Sellers have to receive payment; buyers have to make it; and claims to money are sold and bought to the great convenience of traders and the economy of money. As merchants form a link between producers and consumers and buy from the first to sell to the second, bankers and bill brokers purchase claims to receive payment in national or international money and sell them, mostly in the form of remittances or drafts, to people who have to pay in the country or abroad. The reciprocal liabilities of two nations, as of two individuals, are not equal and the balance may be paid as much by the remittance of a bill of exchange as of gold. Bills can be transferred by indorsement and are always available in all parts of the world for payment abroad. India, for instance, imports more from England than she exports to that country and may be expected to make a remittance of the balance due to her. But if India is a debtor to one country, she is the creditor of many whose Indian imports exceed their exports to India. The liability of India can thus be transferred to other countries, who are, on the balance, her debtors. On account of England's extensive commerce and shipping, her well established banking and insurance business and the stability of her standard of value, London has become a great financial centre though the preeminence was shaken by the war and was challenged by New York. A bill on London is in universal demand and such bills are drawn, by arrangement with banks in all parts of the world, and become a convenient means of making payments.[1]

200. Foreign Exchange :—In domestic exchange, that is exchange between one part of a country and another, there are no complications of different currencies such as those which characterise foreign exchange. The currency is the same and the only thing to be done is that provision has to be made for making remit-

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1 See Hartely Withers: Money Changing, Page 111.

tance of money for commodities purchased. The actual remittance of money involves trouble, risk and cost ; and in minimising these, lies the improvement of the system of exchange. In the busy season in India, rupees and currency notes, particularly the former, are sent from the port towns and commercial centres to the districts for payment to cultivators for their crops. But shroffs and banking houses finance this trade, and remittances are made through the instrumentality of bills or 'hundies.' A merchant who wants to make payment to a dealer in a distant place, will buy from a local banker a hundi for the required amount, and it will be duly cashed when presented and the remittance will thus be effected. Similarly, the seller of commodities will sell his right to receive money to a banker who will recover the amount from the buyer and will receive a small reward for his trouble and expense. This hundi system has been in vogue in India for centuries and the internal trade of the country has been financed through its means.

Before the days of railways, the post office and a unified currency, domestic exchange in India was surrounded with difficulties. The insecurity of carriage of bulky money from one place to another, was a serious difficulty, and therefore hundi rates were likely to be high and liable to fluctuations. But our indigenous bankers had an excellent organization and their system of remittance and trade finance worked with wonderful success. Even to-day, exchange between British territory and some Indian States which have their own distinctive currencies, is just like dealing in foreign exchange. The exchange between British India and the Nizam's Dominions is not unlike that between two foreign countries. But on the whole, internal exchange has been very much simplified by the facilities which are now available. That exchange, briefly, involves the question of the price of money in a particular place as expressed in the terms of the same currency, made available in another place,and it is governed by the expense (including interest) and risk of remitting money and is regulated by the relation between demand and supply. The charge made by the banker is the price of the remittance.

To understand the nature of foreign exchange we have to extend to it this idea of domestic or internal exchange. The problem of foreign exchange is complicated, even in normal times, by the differences in the currencies of different countries, but the potent governing factor there also is the volume of imports and exports

and therefore the supply of and demand for remittance. The uncertainties relating to exchange between gold standard and silver standard countries or countries having a gold standard and those with paper currencies, are very great. The instability and fluctuations in the Indian exchange during the twenty years preceding the closing of the mints in 1893, may be recalled here as an illustration. Even as between two countries having the same monetary standard, however, exchange may not be stable under certain circumstances, and the state of the exchanges of European countries with one another and with the U. S. A., during and after the war, is an instance in point. The indebtedness of a nation to others resulting from an excess of imports or from interest payable on foreign loans and obligations, will depreciate its currency, and the unprecedented fall of the mark and the croner and the vagaries of the franc in post-war years, illustrate the effect of the operation of these factors. There are several forces at work even in times of peace, which affect foreign exchanges in different circumstances.

201. Rate of Exchange :—The mutual relation of the monetary standard and foreign exchange is intimate : in fact, they are two aspects of one and the same thing. This must have been obvious from the simultaneous references we have frequently made in this and the preceding chapter to India's standard of value and the rupee-gold exchange ratio. The rate of exchange is the rate at which a definite amount of foreign money can be obtained and laid down in another country by the payment of national currency in one's own country. A merchant who wants to make a remittance in a foreign country, inquires how much he will be able to pay to his creditor abroad with a definite amount of the internal currency, or which is the same thing, how much of the currency of his own country will be required to lay down a definite amount of foreign currency in another country. If the rate of exchange between London and New York is declared to be 4·866, it means that an English merchant will be able to remit that amount of dollars to America by paying one sovereign in London ; or an American exporter will receive 4.866 dollars for one £ worth of goods exported to England. Similarly, if the exchange on Paris is 25·225, the same merchant will lay down that amount of francs in Paris by paying one sovereign to his banker in England; or an English dealer will receive one £ for a claim on a French merchant, worth 25·225 francs.

The rate of exchange between countries having the standard coin made of the same metal, will be the relation between the weights of the metal of a particular fineness, contained in the coins. Internal money is convertible into gold in each country, at least for foreign remittance, and it is therefore, possible to maintain the above relative position in international exchange. This is the 'mint par of exchange,' and the actual rate will be above or below the par as the country has to receive more or less from foreign countries than it owes to them. The fluctuations in the rate of exchange are, however, limited to the 'gold points,' and of the two methods of remitting money abroad, viz. sending gold and sending a draft or a claim to the payment of a particular amount, that one will be chosen which is less expensive.[1] If the charge for remitting gold is lower than that for posting a bill, the former alternative will, of course, be preferred to the latter. The relative pre-war normal value of the English sovereign and the French Franc was 25f. 22c. to the sovereign, which was the mint par of exchange. If the cost of remitting one sovereign to Paris is say 7c. it will buy only 25f. 15c. in that city. A London merchant will prefer to buy a bill and send it rather than remit gold if he can obtain, say 25f. 18c. in Paris by the former method. This will, however, depend upon the mutual indebtedness of England and France and the ability of either country to balance the debits and the credits by means of arbitrage, that is, drawing upon third parties. Such is the simple way in which is determined the rate of exchange lying between the gold points in normal times.

There can, of course, be no mint par of exchange between countries having currencies of different metals, but the general principles of foreign exchange given above apply also to the reciprocal relation between those currencies. The fluctuations in the rate of exchange will, in these cases, be great, but at any given moment

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1 "When the number of people who want to send from Sydney to London is greater than the number of those who want to send money from London to Sydney, the latter will be in an advantageous position, and able to buy drafts on favourable terms, but the amount in Sydney that the sovereigns or cheques representing sovereigns in London will fetch can not rise above the exact equivalent plus the cost of remitting coin from one centre to the other. When that point is reached the exchange is at gold point."—Hartley Withers: The Meaning of Money.

there will be a definite rate at which the currency of one country based on gold may be converted into that of another having a silver or paper basis. The market price of silver and the quantity of the paper money in circulation, will determine this rate of exchange. The exchange on India before 1898 and on China even at the present day, are instances in point. The excessive issues of paper money in Germany, Austria and Russia in war time were responsible for the abnormally low exchange values of their currencies expressed in terms of gold or sterling. The British and French exchanges, as compared with the American, shared the same characteristics, though on a smaller scale. Export bills and remittances have a current market price like common commodities and these are subject to the operation of the law of supply and demand. Owing to the prevalence of high prices induced by the superabundance of currency caused by financial necessities of the State, the imports of a country exceed its exports and the supply of bills falls short of the demand for remittance, with the result that more units of national money have to be paid for procuring foreign currency and there is little gold available for export. Exchange thus falls and becomes unfavourable.

202. Exchange Quotations:—The current rates of exchange quoted from day to day take account of the charge for remittance and are based upon the condition and the prospects of the trade and the money market at any given time. The bankers have to wait till the bills they buy, mature or are discounted by them. This cost they will add to the price they ask for remittance or deduct from the price they pay for their purchase according to the nature of supply and demand. In the exchange market, as in other dealings, sales and purchases are "ready" or "forward", and bankers 'cover' their transactions in order to maintain an equilibrium in their dealings. As banks must make a profit, they have their selling and buying rates which leave them a margin of gain. There is one other matter which it is necessary to make clear in this place, and it relates to the way in which foreign exchange is expressed. We may state either how much of foreign currency a unit of our national currency will buy or how much of our own currency will be needed to purchase a unit of foreign currency. These are two ways of expressing the same relation, but are likely to create confusion in the minds of the uninitiated. Thus in London, the exchange on New York and Paris is stated to be

\$ 4·86 and 123f. 20c. respectively but that on Bombay is said to be 1s. $6\frac{1}{8}$d. That is to say, while exchange in London with reference to the first two countries is expressed in terms of the foreign currencies that on Bombay, is expressed in terms of British money. From this, the Indian end, we may say that one rupee will buy 1s. $6\frac{1}{8}$ d. in London but on the same principle, the exchange on Bombay would be expressed in London by being stated as Rs. 13–14–0, which is the amount of the Indian currency that the sovereign will buy in this country. But it is the practice to express both, the exchange on London and that on Bombay, in English currency and it will be, say 1 s. $5\frac{2}{3}$ d. and 1s. $6\frac{1}{8}$d.

The expressions 'high' and 'low' and 'favourable' and 'unfavourable' exchange will prove misleading unless the sense in which they are used in particular cases is clearly understood. Exchange which is 'low' from one point of view, will be 'high' from the other viewpoint. A similar statement may be made with regard to 'favourable' and 'unfavourable' exchange. A rate of exchange which is favourable from the point of view of importers is unfavourable from that of exporters. But exchange is generally said to be favourable to a country when it is in a position to receive more of a foreign currency for a definite amount of its own; because it is in having to make excessive remittances abroad that the danger of exhausting national stocks of gold and embarrassing the banks of the nation by reducing the available backing for credit, is involved. National stocks of gold are jealously guarded as on them is reared the whole superstructure of a nation's system of credit. As soon as there are signs of a coming demand for the export of gold, banks raise their lending and discount rates and thus discourage the operation and even attract funds from abroad. It is interesting to note that low or 'unfavourable' exchanges were advantageous to producers and exporters in countries whose currencies had depreciated, that is, lost their power of purchasing gold or international currency, because they received for their goods more in national money than in normal times. Depreciated exchanges were, therefore, looked upon as a menace to the industries of Great Britain, India, the U.S.A. and the British Dominions and were made a ground for anti-dumping measures. The Indian government has regarded a high exchange rate as conducive to the best interests of the consumers and tax-payers though it has ever been a subject of protest on behalf of the large body of producers,

203 Indian Exchange:—Having briefly stated the general principles of foreign exchange, we shall now proceed to describe the nature and the course of exchange in the case of India. The question of foreign exchange has played a very important part in the development of the currency and financial organization of India owing mainly to three causes: (1) First, the standard of value, as described in the last Chapter, was for many years in India, a silver standard. With the steady fall in the gold value of silver, owing to the appreciation of the yellow metal, the exchange with countries having a gold standard went lower and lower till the fall was arrested by the closure of Indian mints in 1893. Exporters of goods from India temporarily benefited by a steady fall in exchange as they received more silver rupees in India (the mints being open at the time), for the same quantity of gold obtained in foreign countries as the price of those goods. But importers of commodities from abroad and others who had to make remittances to foreign countries, had to pay more rupees to obtain the same quantity of sovereigns in London. A continuous adjustment between prices and exchange took place; and it was not, therefore, so much the question of the former as of the uncertainty of the rate of the latter that attracted attention. With the adoption of a gold standard, the problem of exchange lost its terrors, and fluctuations in the rate were severely and permanently restricted, till the equilibrium was violently disturbed in war time and during the period immediately succeeding the cessation of hostilities.

(2) The second factor in the situation has been the obligation resting on the Government of India to remit a large amount of money every year to the Secretary of State for meeting the Home Charges. Government was, therefore, deeply interested in bringing about the stability of exchange so that it might estimate with a degree of definiteness the amount of rupees it must provide from year to year and might not have to suffer deficits and losses owing to the depreciation of the currency as compared with gold. Even when a gold standard was established in India, it existed for purposes of foreign exchange only, and the responsibility was assumed by government to maintain the value of the rupee at the fixed rate of 16d. to the rupee. Government altered the monetary standard and raised the exchange value of the rupee during war time to make it keep pace with the rising prices of silver. The Indian system was not automatic; and the relation of the rupee with foreign currencies was not

regulated by the normal play of economic forces operating in the world, by the course of the prices of silver and gold and by the course of trade. The balance of trade does indeed determine in India, as elsewhere, the fluctuations of exchange between the gold points, but if the exchange rises or falls beyond these limits, it is manipulated by government by the offer for sale of Council bills in London or the purchase of sterling in India and by the offer of drafts here on London, as we shall presently show. The financial transactions of the Government of India in this country and in London, have exercised a powerful influence upon the development of the system of exchange in this country.

(3) But there is a third factor in the situation, viz. the needs of the import and export trade of the country. The great Exchange Banks, no doubt, finance the export and import trade; but the Secretary of State for India sells drafts on the Indian government to place himself in funds in London and also for the convenience of importers of Indian goods into England. The latter want rupees for the payment of the price of Indian exports to be laid down in this country, and they can obtain rupees either by purchasing the drafts sold by the Secretary of State for India or by shipping sovereigns to this country and receiving rupees and currency notes in exchange for them from the Indian government which has thus acted both as a banker and as a currency authority on the one hand and as a party having to make its own remittances, on the other. The less expensive of the above two methods is, of course, preferred by merchants and bankers. The gold import point is likewise fixed by government operations.

The Secretary of State had often to sell Council drafts beyond his immediate needs for the convenience of trade, and he placed himself in funds for the purchase of silver out of which rupees are coined here. Exchange on India will rise when there is a great demand for remittance to pay for Indian exports in the busy season and will fall in the slack season when exports are reduced and there are very small payments to be made to India. It will similarly fall when, owing to famine or drought, exports from India are reduced. So long as the mints were open, people had the right to take imported silver bullion to the mints and to have it coined into rupees. This import of silver into India competed with the sale of the Secretary

of State's bills in London. But when the mints were closed and the relation between the rupee and the sovereign was artificially fixed by law, government practically got a monopoly of the supply of Indian currency, and foreign merchants could obtain that currency here either through the purchase of Council drafts or the shipment of gold and sovereigns for which rupee currency was always available at a fixed ratio. It is only when the exports from India fall off owing to scarcity or there is an abnormally large import of commodities, that the method of Council bills fails, and the Government of India has to sell 'reverse' bills, and the Secretary of State meets his requirements by drawing upon the reserves, by borrowing or in other ways. The monetary system provides in this manner for the upper and lower limits of exchange or the gold import and export points.

204. Development of the System:—The question of devising a convenient method of remitting funds to England has been often discussed since the beginning of the last century. "The manner in which such remittances could be defrayed with the greatest advantage, engaged the attention of the Court of Directors as long ago as in 1813, when they explained to the Government of India that this might be effected either by advances to the public service which would be repaid by the British government in England, or by remittances through private merchants who would pay money in England in return for bills on the India Government, or would receive advances in India from the Government, to be employed in the purchase of goods consigned to the United Kingdom ; if these methods failed to give sufficient remittances, bullion might occasionally be consigned to the Court of Directors."[1] All these different methods have been followed simultaneously or separately as was found necessary and convenient, and the Government of India have also remitted funds to England by buying bills in Calcutta. The method of selling bills of exchange on the Indian government was found to be the best, and since 1862 reliance has been mainly placed upon it for drawing funds to London. The history of the operation of the system may be best summarised in the words of

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1 Report of the Fowler Committee : Index and Appendices, page 24.

the following extract:—"Sales of the Secretary of State's Bills were at first made (1862) monthly, and at a fixed rate of exchange. By a series of changes fortnightly and then weekly sales were substituted for monthly ones; allotments to the highest bidder took the place of sales at a fixed price; tenders were invited (1876) for telegraphic transfers as well as for bills on India; reductions were made in the minimum fractions of a penny per rupee in the price at which tenders would be received; and applications were invited and received for bills and telegraphic transfers on dates intermediate between the regular fortnightly or weekly sales. Bills and transfers so sold are described as "Intermediates" or "Specials."

"The method of transferring funds from the treasury of the Government of India to that of the Secretary of State on a large scale by the sale of Council drafts is rendered possible by the fact that India has ordinarily a very large trade balance in her favour. Except in years of very deficient crops and unfavourable trade, this balance is so large as to be only partly met by the remittances which banks and commercial houses are enabled to make to India by purchasing the Secretary of State's drafts; considerable portion of the world's debt to India remains to be discharged by other means. Before the closing of the Indian mints to the free coinage of silver in 1893, this supplemental remittance was effected by shipments of silver to India to be coined into rupees; since the closing of the mints it has taken the form of shipments of sovereigns which are received at the Indian mints and treasuries in exchange for rupees at the rate of 15 rupees to 1 *l*."[1]

205. India's Balance Sheet:—The balance of trade is said to be favourable to a country when its merchandise exports to foreign countries exceed its imports from them. But this is a misleading phrase; and the so-called favourable balance may mean the drain of a nation's wealth, while an excess of imports over exports may be indicative of growing prosperity. Great Britain imports more than she exports; but this excess does not represent her indebtedness to foreign countries, but rather the payments made to her by them for services rendered. The exports of India, which are not

1 Report of the Chamberlain Commission: Appendices, page 217.

paid for by merchandise and bullion imports, represent the payment this country has to make to the Secretary of State for 'home charges,' remuneration for the services of foreign bankers and shipping and insurance companies, the profits of foreign firms and remittances of Europeans, resident here. The balance of trade takes account only of visible imports and exports such as are recorded by the customs house. Services rendered by or to people in other countries, which have to be paid for, find no place in it. That balance is consequently incomplete, and the true balance sheet of a nation may be drawn up by including in the calculation, 'invisible' as well as visible items of import and export. The two sides of the Indian account, prepared on this basis, will stand thus :—

Debits	*Credits*
(a) Imports of merchandise.	(a) Exports of merchandise
(b) " gold and silver	(b) Loans raised abroad
(c) " securities.	(c) Remittances of Indian emigrants
(d) Remittances abroad to European families and Indian students, travellers &c.	(d) Remittances to foreign tourists, religious institutions &c. in India.
(e) Remittance of profits of foreigners.	
(f) Services rendered to India by foreign banks, shipping and insurance companies &c. and by creditors (interest).	
(g) Payment due on account of salaries, leave allowances, pensions &c. of government servants and for stores, bullion &c. purchased on State account (Home Charges).	

On pages 365–366 above, tables showing the balance of trade of India have been given. They refer to the visible items of trade; and to arrive at an accurate balance of the indebtedness of India and the outside world, items of "invisible" imports and exports have to be added. In the statement given below, are included, in addition, transfers of funds so far as they are visible, and the total visible balance of accounts is struck. It must be noted that the imports and exports of government stores are excluded from these statistics. The huge imports of silver during the year 1918–19 and

1919–20, for instance, find no place there. Government imports consist usually of arms, ammunition, apparel, telegraphic material, railway plant, carriages, machinery and the precious metals; and the exports, of food grains, opium, coal &c. These dealings are not of the ordinary mercantile character and do not give rise to trade bills, being financed with the treasury and currency machinery of government. They are, therefore, excluded from the usual official presentation of the balance of trade but must be taken into calculation if a satisfactory national balance sheet is to be cast. The remittances made on acconnt of and through government, which are shown in the table that follows, are debits for the imports of government stores and buillion and for home charges representing invisible imports of services.

It is not possible to prepare a complete balance sheet that will account for all the numerous items, large and small, which make up the total of the exchange transactions; but the tables taken together are calculated to give a sufficiently clear idea of the way in which the national debits and credits are balanced. During the five years preceding the outbreak of the war and during the war period, the excess of exports over imports of private merchandise was, on an average, Rs. 78·2 and 76·3 crores respectively. This amount was due to India in payment for her exports and it was paid in normal times, partly by exports of gold and silver to this country and the balance was diverted by the Secretary of State for India by means of the sale of Council bills which were paid by the Government of India in this country. The proceeds of those sales were used to meet the 'home charges,' to buy silver for the coinage of rupees in India, for the repayment of debt and for capital expenditure.[1] The liquidation of

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1 "The annual exports from India are generally in excess of her imports and an adjustment of the value of the net exports is effected partly by remittances through Government, partly by actual shipment of coin and bullion and partly in other ways. The remittances through Government are effected by means of the Council bills and the telegraphic transfers sold by the Secretary of State, which are promises made by Government to pay on demand, at the treasuries in Calcutta, Madras and Bombay, the amounts specified in the bills. The bills thus serve the double purpose of placing the Secretary of State in funds to meet his outgoings in London, and of enabling trade to make a remittance of funds in the opposite direction from London to India."—Report of the Currency Department for 1913–14.

the trade balance during war years was, however, a more complicated affair and we shall explain presently how it was effected.

It must be borne in mind here that the balance of trade is never settled within any period of twelve months like that of the official year, which is made the basis of our calculations, but if longer periods are taken, the adjustment is seen to have taken place. In the case of India, besides the 30 crores that are remitted to England on account of 'home charges,' a large amount, variously calculated, goes out of the country in payments of profits of foreign companies and earnings of individuals. Taking the British capital invested in this country[1] in a variety of industrial and commercial enterprises and in government securities at Rs. 800 crores, we may safely assume that the interest and profit on this amount can not annually be less than Rs. 40 crores. If the excess of exports over imports is not equivalent to these 40 crores *plus* the 30 crores of the home charges, as one would expect, it must be assumed that a part of the above interest and profit it spent in this country and remains to be invested in the financing and the expansion of the trade and industries of India. The following table will give a rough idea of India's visible trade balance. To complete the final balance, some small items of Government remittance must be added, e. g. net payment in India of foreign money and postal orders and telegraphic transfers on India from Iraq, amounting in 1928–29 to Rs. 3·8 crores and reducing the favourable balance from Rs. 10·7 crores to Rs. 6·9 crores. The ultimate visible balance thus worked out for the four years 1925–26 to 1928–29, will be[2] :—

			Crores of Rs.
1925–26	...	...	41·5
1926–27	...	...	34·1
1927–28	...	...	7·8
1928–29	...	...	6·9

1 See H. F. Howard: India and the Gold Standard, page 95.

2 The last two years show a marked decline, but "before the war there was usually a small balance against India which would show that at that time the invisible items as a whole resulted in a transfer of capital into India. The fluctuations since the war, however, have been too violent to make it possible at this stage to draw any definite conclusion from the figures."—Currency Report, 1928–29.

Trade Balance.

(+ REPRESENT NET EXPORT AND — NET IMPORT)

(IN CRORES OF RS.)

	Average of 5 pre-War years ending 1913–14	Average of 5 war years ending 1918–19	Average of 5 years ending 1923–24	1924–25	1927–28	1928 29
Exports of Indian merchandise (private) ...	+219·6	+215·9	+285·6	+384 6	+319·1	+330·1
Re-exports of foreign merchandise (private) ...	+4·6	+8·1	+15·6	+13·5	+9·5	+7·8
Imports of foreign merchandise (private) ...	—145·8	—147·8	—248·8	-243·1	-246·7	-251·4
Balance of Trade in merchandise (private) ...	+78·2	+76·3	+52·4	+155·0	+81·9	+86·[illegible]
Gold (private) ...	—28·1	—7·8	—13·9	-73·9	-18·1	-21·[illegible]
Silver (private) ...	—7·2	—2·9	—11·7	-20·0	-13·8	-13·4
Currency Notes (private) ...	...	...	—·4	-·2	-.2	—·1
Balance of Transactions in treasure (private) ...	—30	—10·8	—26·1	-94·2	-32·1	-34·3
Total Visible Balance of Trade ...	+42·2	+65·5	+26·3	+60·7	+49·7	+52·[illegible]
Council Bills and Telegraphic Transfers paid in India, purchases of sterling from Banks and firms in India and payments for sterling taken over in London from local bodies	—41·3	—34·9	—15·4	-56·3	-37·7	-41·0
Sterling transfers on London sold in India ...	+·5	+5·5	+9·4	...	...	...
Transfers of Government securities ...	—·8	—·3	—·05	-·2	+·2	-·1
Interest drafts on India in respect of Government of India securities ...	—·4	—·3	—·3	-·4	-·3	-·8
Balance of Remmittance of funds ...	—42·6	—30·1	—6·3	-57·1	-37·8	-41·3
Total visible balance of accounts ...	—·1	+35·4	+19·9	+3·6	+11·9	+10·7

206. Liquidation of Balance:—The way in which the abnormal exchange conditions created by the war were met by government, will be explained presently. But it will not be inappropriate briefly to refer here to and illustrate the manner in which India's balance of accounts was made up during the war period as it throws an interesting light upon the 'invisible' imports and corresponding remittances from India and on the general exchange system. The net exports of merchandise from India were comparatively very large during these years, which meant huge external indebtedness to this country. To add to this, there were the recoverable disbursements made in India by the Indian government on behalf of His Majesty's government; and thus invisible exports from this country or foreign liabilities to India were enormously increased, though India's direct contribution to the expenses of the war was, to a certain extent, set off against the amounts due. The total amounts which the Government of India had to find for recoverable disbursements reached enormous dimensions, rising to 120 and 130 millions of £ in 1917 and in 1918.

Let us take the year 1916–17 as an illustration to show how external indebtedness to India was actually liquidated through funds provided by government agency and private invisible imports. The favourable balance of trade to be liquidated in that year was Rs. 90·27 crores. "This means that the number of rupees that were seeking to be exchanged into external currency, such as sterling, dollars, yen &c., in order to pay for India's imports, were outnumbered by the external currency, seeking to be exchanged into rupees in payment for India's exports, to the extent of about 90 crores. Speaking very generally, it may be said that necessary balance of rupees has been found mainly in two ways–(A) by rupees placed at the disposal of trade by government, and (B) by rupees brought foward by people in India who have had to make remittances elsewhere, *i. e.* who have had to turn their rupees into external currency, for some purpose other than in payment for an actual import of goods."[1]

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1 Report of the Currency Department for 1916–17.

Remittances through government amounted to about 59 crores, thus :—

(1)	Council Bills	...	47·07 crores
(2)	Net payment of money orders and postal orders in India	...	3·30 ,,
(3)	Telegraphic transfers &c. issued on India from Persia and elsewhere	...	4·50 ,,
(4)	Paid to a Bank in India on behalf of East African Government which repaid in London	...	3·67 ,,
(5)	Remittances to India from certain Crown Colonies	...	·23 ,,
(6)	Currency notes returned from Mesopotamia and encashed in India	...	·30 ,,
	Total	...	59·04 ,,

This amount still left a balance of about 31 crores unaccounted for. And the Controller of Currency was able to ascertain through the courtesy of Exchange Banks, the extent and the purpose of the remittances made from India during the year 'other than remittances made in payment for imports.' He could, in this way, account for no less than 25 crores of rupees. There were thus remittances from India for investment in the British War Loan, Exchequer Bonds and Treasury Bills, their amount being in the neighbourhood of 7½ crores. Many people resident in England and holding shares in Indian companies realised their profits due to general appreciation in values and remitted them to England. Companies operating in India but domiciled in England, similarly remitted their profits through the Banks and these were estimated at about 7½ crores. To this may be added, on the other side, outstanding credits in foreign countries due to India or the amounts of the postponed remittances of the values of some Indian exports; and the tale of the liquidation of the trade balance is completed. These credits in foreign countries have been recently large and the account we have given above of the balance of accounts for 1916–17 more or less covers the position in the succeeding years.[1] In 1919–20, there was a favour-

1 "...............it is a reasonable inference that, as was surmised in my report for 1917-18, private remittances have not, in recent years, served to the same extent as under normal conditions to finance the excess of exports over imports and that there is a substantial balance in India's favour which has still to be liquidated."—Report of the Currency Department for 1918-19.

able balance of about 115 crores, and Rs. 34·5 and Rs. 18·5 crores worth respectively of councils and reverse councils were sold. A huge balance, therefore, remained to be liquidated. It was, however, a time when, war being over, large funds which had been awaiting remittance, found a convenient outlet and the opportunity was fully utilized also to invest in plant and machinery in anticipation of the coming industrial revival. Even then Indian credits in foreign countries on a considerable scale must have been carried over. In 1920–21, the position was reversed. There was an adverse visible balance of Rs. 76 crores, and part of it was met by the sale of reverse councils and part of it remained unliquidated.

207. Process Explained:—Statistics published by government now show separately in India's 'visible' balance of accounts, the balance of (1) trade in private merchandise, of (2) private transactions in treasure and (3) of the remittance of funds. Indian government's transfers of funds are availed of, to a considerable extent, to liquidate what remains of the balance of accounts after the bulk of the payments arising out of foreign trade have been effected through the mechanism of bills of exchange. The Secretary of State's 'drawings' by means of Council bills and telegraphic transfers are represented as 'imports of funds into India'—a very misleading expression. From the point of view of Indian exporters of merchandise this is obvious enough because they receive payment for their goods from government treasuries in this country as if their sterling drafts had been purchased by importers of foreign goods with the object of making remittances abroad. Similarly exchange banks are enabled thereby to import from abroad their funds realised on the liquidation or the rediscounting of foreign bills sent out for collection. But from the point of view of the nation, as a whole, Council drafts mean also a withdrawal of wealth from India in as much as the Government of India, representing the nation, meets the drafts of the Secretary of State who withdraws funds from this country for spending them in England. An Indian importer may either purchase a sterling bill locally and remit it to his foreign creditor or let the latter draw on him and sell his rupee bill in his own country to be paid off here when presented. The government remittances are, therefore, set off against the exports of goods and are for intangible or 'invisible' imports in the form of services in so far as they are not made in payment of stores and bullion imported on State account. These latter imports

are covered by council drawings, other government remittances and foreign loans and are not, therefore, separately shown in the trade balance as exhibited in government reports. What in reality happens here is that the Secretary of State diverts to himself a part of the funds which otherwise would have come into this country. He is, as it were, an exporter of wealth (services) for which he 'draws' upon India and sells the bills to exchange banks; the Indian government on this side, which imports the services, pays his drafts and thus enables the banks to import funds into this country. As the British trade balance shows an excess of merchandise imports explained by Englishmen's services to foreign countries, the Indian trade balance must show an excess of exports which pays for the services imported. This transaction is of the same nature as if the Indian government, in its capacity of importer of services and goods, purchased sterling drafts from exporters in this country and thus transferred funds to London instead of being drawn upon by the Secretary of State. In fact, this latter method of remitting government funds has been largely, almost exclusively, followed since 1923-24. Import of funds by one party is, therefore, a remittance abroad by another and is practically another aspect of it. In this connection may be mentioned another kind of remittance operations essentially of the same nature. It will be understood that the floatation of a foreign loan is the creation of a credit and therefore an invisible export against which a debit in the shape of remittance abroad or an import of funds may be set off. Sterling loans raised by Indian public bodies like the Port Trusts and the big municipal corporations, and intended to be brought out and spent here may be taken over by the Secretary of State in London and an equal amount may be released by the Government of India to those bodies in this country. This method of making remittances has also been adopted by the Government of India in recent years.

To elucidate the matter further, let us take a simple case and assume that the commodity exports of India (there being no invisible exports) are valued at Rs. 200 crores, that the merchandise imports on private account have a value of Rs. 125 crores and that the net private imports of gold and silver amount to Rs. 25 crores. Let us assume further that sterling bills to the extent of Rs. 150 crores drawn by exporters of goods of that value, are purchased by the importers of foreign merchandise and the precious metals. This leaves

Rs. 50 crores worth of exports to be paid for; and on the assumption that there are no private persons wanting to make remittances abroad and therefore to purchase sterling bills, the only source remaining to supply funds, is the Government of India. The large supply of sterling bills, in the absence of an adequate demand, will depress their value and raise the rate of exchange but the government has to maintain the legal monetary ratio and is bound to provide rupees. The Secretary of State has, likewise, to draw and the government in India to remit funds to London for the payment of home charges. The two are in the position of exporter and importer respectively, and the former draws upon the latter or the latter remits to the former to the extent of Rs. 50 crores. In the first case, British buyers of Indian exports purchase council bills which are paid by the government here, and in the second, the Indian government purchases the sterling bills and the Secretary of State receives payment in London. In either case it is a remittance from India and a debit in the national trade account. It will be recalled that the gap between the values of the commodity exports and imports of a country is filled by the inflow and outflow of specie. In our present illustration Rs. 25 crores worth of it has been imported. If an additional Rs. 50 crores worth were to seek entrance into the country, such a heavy demand would immediately send up the rate of exchange which the government must prevent for the safety of the gold exchange standard. The government consequently throws itself into the breach and offers to provide the necessary funds at a fixed price. This 'import of funds' meets the demand of trade to balance the credits with the debits and at the same time transfers the balances of the Indian government to London for the home expenditure of the Secretary of State. The transaction is a remittance of funds from one side and an import of funds from the other, at the same time. If the illustration is slightly varied and it is assumed that the gap of Rs. 50 crores is in exports instead of in the imports, the void will have to be filled by the export of funds through government agency and there will be a remittance of an equal amount in the opposite direction. The operation here takes the form of government sales of 'reverse' councils. In actual practice, of course, debits and credits are created in numerous ways and transfers of funds take place for a variety of purposes to and from a country, as described in the preceding section.

208. The "Drain":—It can not be too much emphasised that a country's balance of accounts is so full of intricacies and is made up of so many kinds of credits and debits, invisible and visible, apparent and real, that the excess of imports or exports in any particular year must not be taken as a decisive indication of the position of the country with respect to its financial or economic prosperity or deterioration. Excess of exports is ordinarily taken as the result of a country's being the creditor of other communities and is thus welcomed; and an excess of imports is supposed to reverse the position. This view is, however, superficial and wrong. For instance, the favourable balance or excess of exports in a given year, may mean the export of capital lent to foreign countries or may represent the liquidation of debts and the remittances may be carried over from one year to another. In the case of India, however, an excess of exports or 'favourable' trade balance, is a permanent feature of the economic condition of the country, and it has given rise to a prolonged controversy. The excess has been spoken of as a 'drain' of India's wealth and as an important cause of India's poverty. The drain has, therefore, been represented by Indian politicians and economists as a 'tribute' paid by India to England for the latter's political and economic domination; and its reduction has been recommended as a remedy for the improvement of the material and moral condition of the people of this country.

On the other side, a strong protest is made against this method of representing the favourable trade balance, and the excess of exports is shown to be the price of the benefits India receives from British rule and from the use of cheap capital and other services; and its characterization as a 'drain' or 'tribute' is resented as an unwarranted exaggeration. As we have shown in the two balance sheets presented above, the excess of exports can be easily and technically accounted for. It is not, however, a question of mere accounting and we have to go deeper into the matter. If India imports capital and utilises the services of soldiers, administrators, industrial organizers, merchants, shippers, bankers, insurance firms and others, she must pay for those services as other nations do under similar conditions. But it may be asked whether India can not and should not engage her own men and resources for the above purposes on a steadily increasing scale, and to that extent, reduce the payments which have to be annually made abroad. It would be obviously

uneconomic to refuse to employ cheap external capital and the indispensable services of foreign experts; but it is not less wasteful for India to continue to depend on foreign services and to let indigenous talent and resources lie undeveloped and idle. Years ago, the unjust financial burdens with which this country was saddled and which, in fairness, should have been borne by England, were a subject of repeated complaint, and the economic loss involved in such payments, is quite obvious. To reduce the charges India has to pay to foreigners for defence, for administration and for industrial, commercial and banking services, by enabling the Indian people, as far as possible, to do what outsiders are doing for them to-day, is the direction the policy of the State has to follow; and the Government of India is being constantly urged to adopt that policy.[1]

The 'drain' theory is some times ignorantly conceived and crudely put, and is akin to the old mercantilist doctrine. That is no reason, however, why it should be condemned wholesale. The substantial truth it represents ought, therefore, to be clearly understood and properly recognised. It is but fair that the benefits derived by India from the British connection, should be frankly admitted. These are patent and can not be denied. India may be reasonably expected to pay for these benefits and that price she has paid and is paying to-day in the economic as well as other spheres. But the goal of British policy in this country can not be any other than to make India autonomous and efficient in every respect. There are people in England and in India who do not see any advantage to their own country resulting from the British Indian connection. The point to be stressed here is that the domination of England in India has conferred decided benefits upon the former and entailed certain serious disadvantages on the latter. And it is but natural that Indians should wish that the disadvantages should be reduced and stopped and that they should be placed in a position to manage their own economic and political affairs and derive full benefit therefrom. Satisfactory eco-

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1. See the works of Ranade and R. C. Dutt and Dadabhai Navroji's 'Poverty of India', and also Report of the Welby Commission and the Author's "Gokhale and Economic Reforms", pages 41-44.

nomic progress is not possible in India unless Indian enterprise and efficiency are promoted and self-reliance and self-improvement are encouraged by the State. The adoption of a policy of protection and the demand for the rapid Indianisation of the services, are illustrations of the problem; and the nature and the merits of the 'drain' controversy can not be appreciated without a firm grasp of the above fundamental considerations. It is not mere politics as it is some times represented; it is national economics. So long ago as in 1859, speaking in the House of Commons, Lord Stanley frankly showed what India's 'tribute' to England was; and he remarked:—"I believe the amount of contribution, not to public, but to private necessities, from the people of India to the people of England, can not be taken at less than from £5 to £6 million sterling. Now, that is a sum which in striking a balance between England and India we can not fairly leave out of sight".[1] This was spoken nearly seventy years ago and the "contribution" has increased manifold since that time.

209. Council Drafts:—The Secretary of State for India can conveniently draw funds from this country by selling his drafts and enable trade to remit funds to this country. The same result is secured by the Government of India purchasing sterling in this country. Owing to India's normal favourable trade balance, there is an excess of sterling bills over demand for remittance, with the result that purchases of the former lead to the accumulation of funds in London. Exchange banks, therefore, buy council drafts or sell sterling bills to transfer money to India. With funds thus obtained from the public treasuries, these banks purchase bills of exchange drawn on foreign importers of Indian produce and recover their money here or in England, to be once more used to buy council or sterling drafts. The rate for the Telegraphic Transfers is, of course, a little higher than that for bills as they save the lock-up of funds for two or three weeks necessary in the case of the latter, and the advantage of the Telegraphic Transfer is that money is immediately available to buyers in India. The rate of exchange depends upon the demand for remittance either way, which is regulated by the volume of Indian exports. If these are heavy, the exchange rises, though it must be below the gold point.

1 See the Author's "Dawn of Modern Finance in India", pages 53–55.

But when owing to famine or other causes, Indian exports fall off and do not sufficiently set off the imports, invisible and visible, there is no demand for Councils, and no offer of sterling and there is a demand for remittance in the opposite direction. Importers of foreign goods into India can not obtain bills on London and as the Indian currency consists mainly of silver, government is called upon to supply gold for remittance purposes as they have to discharge the obligation of supporting exchange. Government, therefore, sells drafts on London or, 'Reverse Councils', as they are called, and the Secretary of State meets them from the funds that are at his disposal, the treasury balances or the Currency Reserve or the Gold Standard Reserve, as may be convenient.

Experience gained in 1908–9 and in the years of the war, showed how an adverse balance of trade could be met by the release of gold in India and more particularly by the sale of sterling drafts. In the course of the years 1916–17 and 1917–18, the balances of the Government of India were so depleted by the disbursements they made in this country, on behalf of His Majesty's government, that the Secretary of State had to restrict his sale of council bills. Funds could not then be brought out to India and gold from the Currency Reserve had to be released to meet the demand for currency, which was not satisfied even with the extraordinarily large issues of rupees and notes which had been made. The history of the exchange transactions of 1908–09 and of the years of war is, therefore, very instructive. Towards the close of 1907, owing to a financial crisis in America and a failure of rains in this country, the world's money market became tight and the Secretary of State could find no buyers for his Council drafts except at abnormally low rates. On the 6th November, tenders dropped to 1s. $3\frac{23}{32}$d; and the exchange steadily went down to 1s. 3d. These quotations were below the point at which it becomes profitable to export gold bullion or sovereigns from India. Government hesitated as to the course of action to be taken and at first released small quantities of gold in exchange for rupees; but as the stock of gold was limited, they had to sell sterling drafts to the extent of £8 millions till the crisis was over and exchange again became normal. A similar procedure had to be followed in 1914–15, in 1915–16 and in later years, particularly in 1920, when also reverse councils were sold in India in large quantities and for many weeks.

210. War Time Remittances:—It will be instructive to know how the large remittances made to the Secretary of State in 1916–17, referred to on a preceding page, were digested by him. The Indian government had to spend large sums in this country on behalf of His Majesty's government who repaid those amounts to the Secretary of State in London. This was tantamount to the drawing of funds by the latter by means of Council drafts. But the difficulty was that the demands of trade threatened to remain unsatisfied, and gold being scarce, it could not be shipped to India as might ordinarily have been done. The needs of war operations were paramount and gold in London had to be conserved. Council drafts beyond the budget calculations had, therefore, to be sold and met in this country from increased supplies of notes and of rupees. It was estimated at the beginning of 1916–17 that out of the £22½ million required by the Secretary of State, £18·6 million would be paid in London by His Majesty's government and council bills would be drawn upon the Indian government to the extent only of £3·9 million. The recoverable war expenditure, however, rose to £38½ million and an acute trade demand was met in London by the sale of council bills to the extent of £33 million. The total amount thus transferred to London went up to £71½ million. The two-fold strain of increasing war outlay in India, coinciding with a strong trade demand for remittance to India, was met in three ways: (1) large Imperial and Provincial surpluses enabled government to supply £33 million from treasury balances; (2) the equivalent of £19½ million in new rupee currency was made possible by the purchase of silver in England; and (3) £19 millions were withdrawn from the Currency Reserve and were invested in England.

Of the £72½ million thus received by him, the Secretary of State was to use £21·7 million for his ordinary expenditure, £16·2 million was spent on the purchase of silver and £19 million was invested in the Paper Currency Reserve. £4·3 million, mainly the profit on rupee coinage, was invested on behalf of the Gold Standard Reserve and the balance left, was devoted to the discharge

of debt. These operations may be exhibited in tabular form thus :—

Government of India.	Million £	*Secretary of State for India.*	Million £
Treasury Balances	33	Ordinary Home Charges	21·7
Rupee Coinage	19½	Purchase of Silver	16·2
Paper Currency Reserve	19	Investment in Paper Currency Reserve	19
Total	71½	Investment in Gold Standard Reserve	4·3
		Repayment of Debt	10·3
		Total	71·5

The Government of India was hard put to it to devise means to supply money in this country to defray war expenditure on behalf of His Majesty's government and to meet the Councils sold by the Secretary of State for the convenience of trade. These liabilities of the Indian government reached £111 million in 1917–18, and of this amount, £66 million represented outlay on behalf of the Imperial government. The corresponding figures for 1918–19 were £141·3 and £72·7. The huge demand was met by provision of money out of the proceeds of the war loans and of treasury bills, out of surplus revenue and fresh coinage of rupees and by investment of a part of the paper currency reserve in London. While on the one side, the government in this country experienced great difficulty in providing funds for defraying war disbursements on behalf of the Imperial government, on the other side, the Secretary of State's treasury was flooded with money recovered from His Majesty's government and obtained from the sale of council drafts. Out of the funds thus coming into his hands, the Secretary of State made investments on behalf of the Paper Currency Reserve and paid off a part in lieu of India's war contribution of £100 million. The war gift was insignificant when compared to England's expenditure; but for India, it was large enough; and it helped England in setting off its liabilities to this country at critical moments. A special reserve of £20 million was likewise set apart, to be drawn upon for capital outlay in the future.

The effect of the large remittances to England was the transference of Indian funds on a large scale to that country. Such

transference took place regularly before the war. But the expansion of our paper and rupee currency and the growth of the Gold Standard Reserve Fund have facilitated the remittance of funds to England and their investment there on an unprecedented scale. The total amount of the investment of Indian funds in England owing to war conditions, exceeded Rs. 150 crores. India thus materially assisted the Imperial government by lending it funds and by relieving its liabilities in connection with war outlay in this country. Instead of ear-marking gold in the Bank of England for the Currency Reserve against the issue of notes on this side, government took power to hold a portion of the Reserve in British Treasury Bills. The Government of India provided from its Indian resources, the funds necessary to meet disbursements of the Imperial government in India and took repayment of a substantial portion of the amount so provided, in the form of securities of the Home government. India thus lent to the British government funds required for outlay here as the U. S. A. did for a similar purpose in America.[1] These funds were not used to cancel the Indian public debt in England and the British liability was almost completely offset by India's war gift of £100 million.

211. Function of Council Drafts:—Normally the Secretary of State sold a larger amount of council drafts than was necessary to yield him the funds that were required to meet the 'home charges'. He used to draw up to the utmost limit of the cash balances in this country and also from the Paper Currency and Gold Standard Reserves. It was contended that requirements of trade had to be met and the demand for councils must be satisfied to the full limit. If this was not done and the sale of council bills was restricted to the amount of home charges, sovereigns would be imported into India to be presented at currency offices for conversion into rupees and thus to render the gold portion of the Currency Reserve inconveniently bloated and only to be shipped back for the purchase of silver. The Secretary of State, therefore, sold freely and accumulated large amounts of Indian gold in London. These funds were partly invested in securities or lent for short periods to banks and were partly used for repayment of debt. This policy of drawing away

1 See Sir William Meyer's speech in introducing the Financial Statement for 1918–19, and also the Author's "India's War Finance and After."

Indian gold beyond the requirements of the home charges, detrimentally affected the industrial, commercial and financial conditions in the country and was strongly criticised in the press here and in England,[1] though strictly from the point of view of an exchange standard, it could be plausibly maintained, there was nothing wrong in the procedure.

The India Office met these criticisms by pleading certain exceptional circumstances as the cause of the accumulation of large balances in London and by defending its system of the sale of bills on the ground of convenience and economy. It was contended that there was decided advantage in selling bills in anticipation of a falling rate and of opportunities of suitable investment and utilization for the avoidance or reduction of sterling debt. But even if there was some truth in this argument, the thing had been undoubtedly overdone and even the Chamberlain Commission was constrained to hold on this point that "the India Office perhaps sold Council Drafts unnecessarily at very low rates on occasions when the London balance was in no need of replenishment," though it could not recommend any restriction of "the absolute discretion of the Secretary of State as to the amounts of drafts sold or the rate at which they are sold, provided that it is within the gold points." The Commission, however, distinctly stated that general public interests ought not to be subordinated to the demands of trade. What is the proper function of council drafts? Are they to be sold for the benefit of traders and bankers who seek a cheap and prompt means of bringing out funds to India? If the principle underlying the gold exchange

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1 "An Indian correspondent" wrote in the *London Times* in November, 1912 as follows:—

"It means that many millions sterling of Indian money have been improperly withdrawn from India. They represent sums extracted from the taxpayer in excess of the requirements of the State: capital withdrawn from India for use in London and there used, not in pursuit of Indian interests but for the convenience of joint stock banks trading on inadequate gold reserves...There is therefore no justification for the sale of a single bill by the Secretary of State beyond the actual amount which he needs to discharge his obligations in London. But these excessive sales of bills are a convenience to the exchange banks which have to remit funds to India and it is often cheaper for them to buy bills than move bullion. They also afford a means of obstructing the natural flow of gold to India, and in this way allay the terrors of those joint stock banks who realise the inadequacy of the London gold reserves and are not averse to protecting them at the expense of the Indian taxpayer."

standard is to be strictly adhered to, the answer to the second question ought to be in the affirmative. But the Indian system was a half-hearted standard, and gold was not entirely prevented from going out to India. Complete prevention was impracticable. The Babington Smith Committee emphatically stated that 'council drafts are sold not for the convenience of trade, but to provide the funds needed in London to meet the requirements of the Secretary of State on India's behalf in the widest sense of the term.' The fundamental consideration in this connection is that Indian Reserves should be available for the country's economic development and not merely be invested abroad.

It is necessary to point out here that India's funds, its revenues, reserves and treasury balances, which are located partly in this country and partly in London, constitute one national fund, and two distinct accounts viz. the revenue account and the capital account are kept, the first dealing with the current income and expenditure of government and the second with capital transactions. The pre-war opening balance which the Secretary of State and the Government of India must have at the beginning of the year was estimated at 6 crores of rupees in London and 18 crores in India. All funds, from whatever source they come, go into the balances and payments are made out of them. An estimate is framed early in the year as to the position of the balances, the amount that must be borrowed here and in London for financing the public works programme and the repayment of temporary and permanent debt and the funds that the Secretary of State may draw from India by the sale of Council drafts. This estimate is rarely adhered to and 'the ways and means' programme is modified in the course of the year, larger sums being drawn from India than those estimated. Thus during the five years 1901–6, about 50 crores of rupees were drawn in excess of the budget provision, and 63 crores was the excess during the four years 1909–10 to 1912–13. (There was a deficit of about 10 crores in 1907–08 and 1908–09 owing to failure of the monsoon and a monetary crisis in America.) During war time, conditions in this respect were abnormal and it was impossible to forecast them with any pretence to frame even approximate estimates. When balances were depleted, government had recourse to temporary and permanent loans, to the issue of notes against 'created' securities and to the sales of treasury bills.

The aggregate needs of the Home Treasury are met out of sterling remittances from India, borrowings in London and drawing upon the Currency Reserve located at the latter centre according to exigencies. The total disbursements of the Secretary of State for India amounted in 1928–29, to £40·7 millions and were met to the extent of £30·8 millions from sterling purchased in India, of £6·9 millions from net permanent debt incurred and of £2 millions from miscellaneous receipts. Remittance of funds to London can be made by the purchase of sterling bills in this country as well as by the sale of council drafts by the Secretary of State. The normal method until recently was "the sale by tender in London once a week by the Secretary of State in Council of rupee bills or telegraphic transfers on the Government of India supplemented by sale of intermediates at higher rates between the weekly sales."[1] In 1923–24, the sales of these 'intermediates' in London were replaced by the purchases of sterling in India from exchange banks and recognized firms, and next year, the system was adopted as the chief method of remittance. The advantage of this change lies in the fact that government here is better able to gauge the conditions in the money market and promptly to adjust its operations to them.

212. Rate of Remittance Drafts :—The actual distribution of Council drawings and sterling purchases over the twelve months of the year is regulated according to the course of the Indian trade which is of a seasonal character. A demand for drafts on this country arises and sterling drafts are available when remittances have to be made in payment of its commercial crops. The months of brisk export trade, October to the end of March, constitute the 'busy season', the remaining part of the year being the 'slack' season.[2]

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1 Report of the Controller of the Currency for 1923-24.

2 "The Indian year, as is well known, is divided broadly into two seasons : the busy season, extending roughly from the 1st of October to the end of March, and the dull season, extending from about the beginning of April to about the end of September. Thus the financial year begins with the dull season, during which the demand for the Secretary of State's bills as a means of remittance of funds by the public from London to India is less strong than during the autumn and winter."—Chamberlain Commission's Report, Appendix VII.

Council drafts can, of course, be sold and sterling purchased on advantageous terms during the busy season, but monsoon conditions and the course of export trade, can not be anticipated; and the Secretary of State used to sell his drafts in both the seasons, as he wanted funds to meet various obligations during the first as well as the second half of the financial year. The gold value of the rupee being fixed by law and the Secretary of State for India having bills of exchange worth crores to offer annually to draw funds to London, government was in a position to fix the rate of the Indian exchange, of course, within the obvious limits. The Government of India now manages its remittance programme by the purchase of sterling on the same principle and in the same manner. And when exchange was at 16d., the Secretary of State would offer to sell rupees to any amount at $16\frac{1}{8}$d., the rate being lower when demand for remittance was slack. The proceeds of the council bills and sterling drafts are devoted to (1) current outgoings, (2) transfer to Currency and Gold Standard Reserves, if bills have been met in India out of these Reserves, (3) repayment of debt, temporary and permanent, and (4) avoidance of debt.

We are not directly concerned here with government balances and borrowing operations. It will be sufficient to remark that for the capital programme of each year, loans are floated in London and in India, and the larger the amount the Secretary of State can draw, the smaller will be his borrowings in the London market. India's gold import and export points were, in pre-war years, slightly over and below the fixed rupee-sterling exchange by about $\frac{1}{8}$th of a penny. The rate of $16\frac{1}{8}$d. could be obtained during the busy season without difficulty; but slightly reduced rates had to be accepted in slack months when money conditions in the market were easy. "In 1909–10 a rate below 16d. continued for the first six months of the year. In 1910–11 it lasted from the middle of May to the middle of August. In 1911–12 the fall appeared only for two weeks in June while in 1912–13 it never fell below 16d. during the first nine months of the year[1]." How the drawings by means of Council drafts and purchases of sterling bills are distributed over the year in a normal year and may be disturbed in abnormal conditions when 're-

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1 Report of the Currency Department, 1912–13.

verse councils' have to be sold in India, will be clear from the following tables :—

(I)

	Sale of Council Drafts (In lakhs of rupees) 1913-14	1916-17	Sterling purchased in India (In millions of £ and crores of Rs.) 1928-29 £	Rs.	Average Rate 1928-29 s. d.
April ...	3,92	1,80	3·6	4·8	1—6
May ...	83	2,94	4·4	5·8	1—6
June ...	1,50	1,39	·7	·9	1—6
July ...	1,31	1,20	...	...	...
August ...	1,70	1,55	...	...	...
September ...	4,09	1,40	1·1	1·5	1—6
October ...	6,12	4,14	4·5	6·0	1—6·05
November ...	4,11	10,58	3·0	4·0	1—6·06
December ...	5,90	8,45	3·4	4·5	1—6·06
January ...	6,80	4,67	1·9	2·6	1—6·06
February ...	4,91	5,94	3·8	5·1	1—6·06
March ...	3,41	4,88	3·9	5·2	1—6
	46,60	49,04	30·1	41·0	1—6·02

(II)

Drafts sold in 1915-16 and in 1918-19

Month.	Sterling transfers on London (in thousands of pounds).		Council bills and telegraphic transfers (in lakhs of rupees).	
	1915-16	1918-19	1915-16	1918-19
April ...	......		1,53	4,35
May ...	......		1,03	5,98
June ...	651		17	5.09
July ...	3,377		8	5,75
August ...	......		23	4,53
September ..	815		2,17	2,48
October ..	50		2,25	2,59
November ..	......	5,315 (November–March)	2,02	14
December ...	......		3,28	......
January ...	......		5,26	......
February ...	......		6,02	......
March ...	......		6,33	......
Total ...	4,893	5,315	30,37	30,91

(III)

Trade Balance and Sale of Drafts.

Year	Net Exports Private merchandise	Net Imports of Private Treasure	Govt. Remittances to London	Average Rates	Sales of Reverses Councils	Average Rates
	Crores of Rs.	Crores of Rs.	Mill. of £	s. d.	Mill. of £	s. d.
1906-07	68·2	21·6	34·0	1-4·0	......	......
1907-08	47·4	27·3	15·7	1-4·0	·70	1-3·9
1908-09	31·7	16·6	13·3	1-3·9	7·9	1-3·9
1909-10	70·3	31·0	27·8	1-4·0	·15	1-3·9
1913-14	65·6	29·5	31·2	1-4·0	......	......
1914-15	43·6	18·4	7·1	1-4·0	8·7	1-3·8
1915-16	65·3	10·4	20·8	1-4·0	4·8	1-3·9
1918-19	84·8	·08	22·5	1-5·4	5·3	1-6·0
1919-20	125·9	10·8	31·2	1-9·6	24·5	2-7·7
1920-21	77·5	1·2	......	......	30·9	2-2·0
1921-22	20·9	12·1	......	......	......	......

The financial year 1915–16 opened with a weak exchange and small quantities of bills were sold in the first two months. In the next three months the sales practically ceased and sterling transfers had to be sold on London. In April, tenders had been accepted by the Secretary of State at 1s. $3\frac{15}{16}$d. for bills and the rate in May fluctuated between ls. $3\frac{15}{16}$d. and ls. $4\frac{1}{32}$d. The exchange steadily rose to 1s. $3\frac{31}{32}$d. towards the close of August and to 1s.$4\frac{1}{8}$d. in December. Sterling drafts were sold by the Government of India at 1 s. $3\frac{29}{32}$d. per rupee. In the years 1916–17 and 1917–18 the exchange ruled high. In 1918–19, there was a good demand for councils during the first seven months of the official year, but from November onwards a demand for drafts in the opposite direction was steadily maintained. As we have already explained, the Government of India had to spend very large amounts for His Majesty's government who repaid the sums in London to the Secretary of State. It was difficult, with the depleted treasury balances in India, to meet council drafts for which demand was exceptionally heavy. As a result, ex-

change went up, those desiring to make remittances to this country having to pay more pence than usual while a rupee paid in India could buy a larger amount of pence in London. The Indian system of exchange could be managed in stormy weather only by the use of its two safety valves—the expansion and the contraction of the currency—by the sale of drafts in either direction. But its mechanism broke down when it was called upon to face unexpected dangers in the latter part of the war period.

213. Abnormal Developments:—In order to explain clearly how and why the breakdown of the mechanism occurred, it will be useful to recall briefly the basic principles of the system. It has been shown above how exchange between two countries arises, how it is expressed and what part the India Office and the Government in India play in regulating the Indian exchange. The rate of foreign exchange is ordinarily the relation the metallic contents of the standard coin of the country bears towards those of others. Between countries with a full gold standard the par of exchange is, therefore, simple. In countries where gold is, however, adopted as the measure of value only for exchange with other countries and the internal demand for currency is met by silver tokens or paper, the relation of the national currency with gold is fixed by government and is maintained by means of the regulation of the supply instead of being left to be adjusted by economic forces. The experiment of such a system of a gold exchange standard having proved successful in India, it has been adopted in Mexico, the Straits, the Philipines and Porto Rico and was temporarily forced on European countries by extraordinary war conditions.

Under the ordinary system of exchange, the rate fluctuates between the 'gold points' and is regulated by the relation between the demand for and the supply of bills of exchange or the import and export of commodities. The whole business is managed by banking houses and the government has little to do with it. In countries where the gold exchange standard prevails, it is otherwise. There the government is bound to maintain the artificial rate of exchange it has fixed between gold and the token currency. The duty of a State ought ordinarily to be to give to the people suitable media of exchange of guaranteed weight and fineness and then to leave prices and exchange rates to be determined by the operation of the normal economic forces and

managed by banks. The intervention of the State is called for and justified only in exceptional circumstances, and the great war provided numerous instances of such interference in all countries. In India, however, management by the State has been the rule, and non-interference is exceptional. A system of exchange is indeed not bad simply because it is State 'managed.' A central national bank has to manage it if the State is not to interfere. In India, there is a divorce between banking and currency management and these have been very partially combined under government control and confusion has resulted. It is essentially the nature of the management and its effects upon the trade, industries and the economic condition of the people, that make all the difference.

The government undertakes, under the scheme of managed exchange and currency, to supply currency at both ends and thus to maintain the parity of gold and the tokens. It maintains exchange funds inside and outside the country and sells drafts both ways as necessity requires. The foreign importer of Indian goods will prefer rupee drafts to gold shipments because the former are cheaper. The Indian exporter is able to negotiate his bills at a trifle less than the fixed rate of exchange and the Indian importer of foreign goods buys the sterling drafts by paying a little more than that rate. As normally India has had a favourable balance of trade and the government controlled the supply of rupees, little difficulty was experienced in maintaining the legal rate of exchange.

The stability of the exchange standard is, however, threatened when government is not in a position to maintain the artificial value of the token coins in times of trade depression or financial crisis. The difficulties experienced by the Indian government in 1907–8 and during the war period, have been already described. Danger may assail the exchange system at either end. On account of a large excess of Indian exports over imports the demand for the Indian currency rises, the exchange rate goes up and, owing to monetary stringency or inadequate government balances to meet them, sufficient quantities of council drafts can not be sold. Or, owing to a diminution of exports, importers do not secure an adequate quantity of sterling drafts and exchange falls, the rupee being able to purchase a smaller number of pence. In the second case, rupees seek gold but do not get it at a reasonable price; and government, which is

bound to maintain the legal rate of exchange, sells drafts on London for rupees offered to it. The first case is not comparatively so inconvenient as under it government has only to coin fresh rupees or issue currency notes. But there is another contingency which was little contemplated in the discussions of the Indian currency system which were carried on for two generations. The problem to be faced was all along the continuous fall in the price of silver and the consequent continuous decline in the gold value of the rupee. It was one thing for government to be required to coin and supply sufficient rupee currency in times of monetary stringency and supply gold or sterling drafts when there was depression. But it was a radically different matter for it to be called upon to issue rupees at a rate or price which was lower than the cost of manufacturing the coins. Few dreamt that a time would come when the value of the silver content of the token rupee would go above its face or legal value.

But the unexpected did at last happen. In 1916-17, there was an abnormally large balance of trade in favour of India, the sellers of sterling exchange greatly outnumbered the buyers, and as there was little import of gold to fill up the gap, the former had to accept any price in rupees that was offered for their bills. The supply of export bills, that is of sterling, being larger than the demand, they fetched a smaller price in rupees which is the same thing as saying that the rupee came to be worth more or equivalent to more than 16d. Or, to put it in another way, the remitters of funds to India for the excess exports of this country, did not find a sufficient number of sellers of rupee bills and had to pay more for each rupee they wanted to lay down in India. And thus the exchange value of the rupee rose. In January, 1917, the exchange rose to heights that had never been reached since the sterling value of the rupee was fixed. An attempt was made by the exchange banks to arrive at an agreement not to sell telegraphic transfers on London above 1s. 4d., but it failed and exchange transactions are reported to have been put through at as high a rate as 1s. 6d.

The soaring exchange was brought down to 1s. 4d. by the intervention of the Secretary of State who induced the London offices of the Exchange Banks to pin their Indian branches to a rate of

1s. 4d. for T. T.s on London. Whatever resources were available in India, had to be first devoted to the financing of exports of Imperial importance to assist in the prosecution of the war. The Exchange Banks promised to give prominence to such exports and loyally carried out their undertaking. They were, of course, reimbursed for the losses due to their overbought position by the Indian government who allowed them to bring back funds to this country at rates at which they had been taken out. Council drafts were sold during 1917 only to the chief Exchange Banks and a few firms of special eminence on the Approved List who agreed to sell drafts at prescribed rates. The refusal of the Banks to buy bills without full cover[1] caused great inconvenience to export merchants, but the need of financing exports of urgent national importance was paramount and other interests were subordinate. Governments in other countries were similarly compelled to 'peg' exchange by means of rigid control of the movement of gold and by the floatation of foreign loans.

In the crisis of 1907 when our currency system was subjected to a severe trial, the country suffered from a low exchange, and sterling drafts on London were sold, as had to be done again in 1915 and occasionally in later years. But now the exchange soared high and the large quantities of rupees and notes supplied in 1917 were not adequate to the demand. In the one case it was plethora of Indian currency and in the other, insufficiency of it, which upset the exchange organization. We have shown on a previous page[2] how heavy was the outlay of money which the Government of India had to undertake on behalf of the Imperial government. The Indian government did its level best to satisfy the demand for currency by

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1 When banks purchase export bills, they have temporarily to part with their funds and in times of monetary stringency, they are unwilling to discount these bills unless they are supplied with the means to make up their depleted resources. These means are the offers of rupees made by importers and others who want to make remittances abroad, and the sales by banks to them of the sterling drafts 'cover' their purchase of export bills. Merchants who dealt both in import and in export business, could readily provide 'cover' required by banks while those who only exported were at a serious disadvantage in not being able to sell their bills to them for a lack of 'cover'. Those merchants who had remittances to make naturally stood out for higher rates but did not always succeed owing to government control of exchange.

2 See page 584 above.

issuing notes and coining fresh rupees. Owing to the cessation of gold imports, the strain fell on silver which was at the time in universal demand for coinage purposes. The Secretary of State made no arrangement with the Imperial government to liquidate its debt to India, and India's war gift to Britain afforded only partial relief. The gross circulation of notes was 60·26 crores in January, 1915, 62·42 crores in January, 1916 and 84·36 crores in January, 1917; it rose to 108 crores in the September of the last year. It shot up to 158 crores in March, 1919 and to 174 crores in March, 1920, decreasing by about 8½ crores on the same date in the succeeding year. The net coinage of rupees amounted to 10·14 crores in 1913–14, to 13·5 lakhs in 1914–15, to *minus* 2·07 lakhs in 1915–16, to 29·38 crores in 1916–17, to 22·64 crores in 1917–18 and to 51·53 crores in 1918–19. The exchange could, however, be maintained at 16d. only so long as the favourable balance of trade could be liquidated and sufficient metallic currency could be supplied (partly even to take the place of gold imports which practically ceased), but not further.

214. Dear Silver and Exchange:—But to add to these difficulties, the price of silver went up to an unexpected height. The rise was at first small and slow, but later on, owing to heavy demand everywhere, particularly in China and India, it became rapid and steep. Before the war, the price of silver was about 24d. an oz.; in September, 1917, it was 55d. and constituted a record since 1878; in February, 1920, it rose to 89d. per ounce. The white metal, which was so long neglected and contemptuously treated, had its revenge. Silver was in demand everywhere for currency purposes. Each nation conserved its gold and multiplied paper currency. The daily expenditure of millions for the conduct of the war caused a tremendous expansion of currency, and silver had its turn. The metallic value of the rupee now exceeded its nominal value and the government had to issue ordinances against the melting of the coins and the export of silver. It also prohibited the private import of silver and acquired the imports of gold at stated prices based on the sterling exchange value of the rupee. These prohibitory measures reduced the Indian silver market to a water-tight compartment and the course of silver prices was erratic, the latter ranging between Rs. 50 and 115 per 100 tolas in the years 1917–18 and 1918–19.

The highest and the lowest prices of standard silver per ounce in London were as follows :—

Year	Price in Pence		Year	Price in Pence	
	Highest	Lowest		Highest	Lowest
1914 ...	27¾	22¼	1918 Dec. ...	48¾	$48\frac{7}{16}$
1915 ...	27¼	$22\frac{5}{16}$	1919 May. ...	58	$59\frac{9}{16}$
1916 Jan. ...	$27\frac{5}{16}$	$25\frac{11}{16}$	1919 Aug. ...	61¾	55¾
1916 Dec. ...	37	$35\frac{12}{16}$	1919 Sept. ...	64	64
1917 Jan. ...	39⅛	38	1919 Oct. ...	66½	62¾
1917 Aug. ...	46	40⅛	1919 Nov. ..	76	65½
1917 Sept. ...	55	46	1920 Jan. ...	85	65⅞
1918 April. ...	49¼	45¼	1920 Feb. ...	89½	82

The advance in the price of silver necessitated alteration in the rate at which the Secretary of State used to sell rupees, viz., the Indian exchange. Owing to the high price of silver, which rose to 46 d. an oz. in August 1917, the rupee was no longer a token : its intrinsic value was higher than its face value. Instead of yielding a profit, the issue of rupees caused a loss, if the Councils were sold at the old fixed rate. The Secretary of State, therefore, put up the rate to 17d. The question here arose, whether government was not expected under its exchange standard system, to maintain the rupee at the 16d. level and to make up the loss by drawing upon the Gold Reserve. The fund built up out of the profits of rupee coinage and expressly set aside for the maintenance of exchange, it was contended, was the source from which the loss should be made good.

The Finance Member met this contention with the plea that the Gold Reserve was never intended to serve the purpose for which it was proposed it should be used, that charging the loss caused by the high price of silver to the Reserve would entail indefinite responsibilities and liabilities and that whatever burden exporters had

to bear, was counterbalanced by the advanced price of Indian produce. He defended the Secretary of State's action in enhancing the rate of exchange to 17d. on the ground that he could not sell his drafts at a price which meant a loss of about one penny for every rupee that was supplied.[1] It was a step most reluctantly taken, he said, but all things considered, it was inevitable and perfectly reasonable. Whatever weight might be given to the other arguments, the contention about the purpose of the gold Reserve was not right. If the rupee is a note printed on silver, the Reserve set aside on its behalf, is the fund that has to be utilised to encash or liquidate it[2]. When the old relation between the rupee and sterling was broken, the value of the rupee followed the rise in the price of silver; and the rate of exchange was put up by successive stages from 16d. to 28d. as shown in the following table :—

Date of Introduction.		Minimum rate for Immediate T. T. s.
3rd January, 1917	...	1 4 1/4
28th August, 1917	...	1 5
12th April, 1918	...	1 6
13th May, 1919	...	1 8
12th August, 1919	...	1 10
15th September, 1919	...	2 0
22nd November, 1919	...	2 2
12th December, 1919	...	2 4

There are two matters which must be noted in this place. First, the price of silver was governed by the policy of control and decontrol pursued by the governments in U. S. A. and Great Britain as well as by the demand in the Far Fast; and second, the rate of exchange in India was regulated by the sterling-dollar exchange. With the passing of the Pitman Act in April, 1918, a control price of 1 Dollar per ounce was established, to be raised in August to 101½ cents. England followed suit and fixed a maximum price of 49d. per standard ounce. When the London-New York exchange was "unpegged" early in 1919, the maximum price was made the equivalent of 101½ cents at the current rate of exchange.

1 Sir William Meyer's speech introducing the Financial Statement for 1918-19.

2 Read B. F. Madon's statement submitted to the Hilton Young Commission.

In May, 1919, the control in America over the export and the price of silver was removed and the restrictions over the maximum price in England were abolished. In the course of 1920–21, there was a gradual fall in the price of silver, 30d. being reached in March, 1921; and combined with an adverse balance of trade, it brought down the rate of exchange steadily to $14\frac{7}{8}$d. in that month. It will be clear from this that exchange is governed as much by abnormal changes in the prices of gold and silver as by the balance of indebtedness.

The disturbance caused by the titanic war, to trade and industries, affected the exchanges all the world over. The normal balance of trade in the case of some of the belligerent countries was violently upset; and England was not able to maintain its exchange with the United States of America, the only important country in the world where the pre-war gold parity was in operation, in spite of large borrowings in that country. In view of the fluctuations and uncertainties of the exchanges of other countries, the disturbance which the Indian exchange suffered, must be regarded as a common lot shared by India with others; and though there is no doubt that, on the whole, the financial and currency mechanism of India was skilfully handled when it is remembered that the machinery was placed at the disposal of the Imperial government for enabling it to prosecute the war with vigour, our government can not be complimented on the way in which they shaped their remittance policy, altered permanently the old ratio between gold and the rupee, dealt with the imports and exprots of gold and silver and managed the sale of reverse councils. Its defence of the Secretary of State's policy referred to above, was lame and laboured and amounted to a confession of failure.

215. Course of Exchange :—We need not repeat what we have stated earlier in this chapter with respect to the methods of expressing the rate of exchange. Below we give only typical illustrations of those methods which will also serve to demonstrate how the exchanges all the world over have been violently disturbed by the war and how there are cases of deterioration, of recovery, of rehabilitation and of devaluation. It should be noted that the war time inflation having rendened impossible the restoration of the old par of exchange, France, Belgium, Italy and Poland have been compelled to devaluate

their currencies and change their monetary standard to fit in with the high level of internal prices :—

Rates of Exchange in London on Foreign Centres.

Place	Method of Quoting.	Par of Exchange.	During 1920.		During 1921		Approximate Price on 1st July, 1922	January 1930
			Highest.	Lcwest	Highest	Lowest.		
New York ...	Dollars to £	4·86 $\frac{2}{3}$	4·59	3·65	4·23$\frac{1}{2}$	3·53$\frac{1}{8}$	4·40$\frac{1}{8}$	4·87
Montreal ...	„ „	...	...	...	4·56$\frac{1}{2}$	3·98$\frac{1}{2}$	4·47$\frac{1}{2}$	4·93
Paris ...	Francs to £	old 25·22$\frac{1}{2}$ new 124·21	68·80	40·75	61·75	45·35$\frac{1}{2}$	52·67$\frac{1}{2}$	123·8
Brussels ...	Belga „	old 25·2 new 35·0	...	...	...	...	...	34·91
Berne ...	„ „ „	52·2	23·33	19·40	24·30	20·08	23·26	25·21
Copenhagen ...	Kroner to £	18·15	25·91	19·60	24·03	18·50	20·63$\frac{1}{2}$	18$\frac{15}{16}$
Amsterdam ...	Florins to £	12·10	25·91	480	11·85	11·06	11·42$\frac{1}{4}$	12·10
Vienna ...	Sohllgs to £	34·58	...	...	...	...	...	34·6
Berlin ...	Marks to £	20·43	365	120	1,275	203	1,557	20·38
Warsaw ...	Zloty to £	old 25.22 new 43·4	43·3	370	26,000	2,200	20,00	43·44
Milan ...	Lira to £	old 25·22$\frac{1}{2}$ new 92·46	106	50	109	70	94$\frac{1}{4}$	93·6
Constantinople	Piastas to £	110	...	...	890	490	730	1070
Madrid ...	Pesetas to £	25·22$\frac{1}{2}$	8·90	18·68	32 50	26·50	28·37	35·3
Bombay ...	Rupee to £	old 16d. new 18d.	33$\frac{1}{2}$d.	16$\frac{3}{4}$d.	18$\frac{3}{4}$	14$\frac{3}{8}$d.	15$\frac{11}{16}$	17$\frac{1}{2}$d.
Yokohama ...	Yen to sterling	24·43d.	36d.	28d.	32$\frac{3}{4}$	27$\frac{3}{16}$d	26$\frac{1}{8}$d.	24·0d
Shanghai ...	Tael to sterling	...	...	...	52$\frac{1}{4}$	35d.	42$\frac{1}{2}$d	27$\frac{1}{2}$d
Hongkong ...	Dollars to sterling	...	...	...	26$\frac{5}{8}$d	26$\frac{1}{2}$d.	31$\frac{1}{2}$d	0$\frac{1}{2}$d
Rio de Janeiro	Pence to Milreis	16d.	18 7	9$\frac{1}{2}$d.	10$\frac{5}{8}$d	6$\frac{3}{4}$d.	7$\frac{17}{32}$	5$\frac{11}{4}$d

In studying the exchange tables, the methods of converting international currencies into terms of one another, should be carefully marked. The mint pars of exchange and the wide departure there-

from of several rates deserve to be noted. The familiar 'gold points' will be seen to have ceased to operate. The Indian course of exchange exhibits the varying purchasing power of the rupee; and the price of silver and the depreciation of sterling are important factors in it. Recent developments reflecting the appreciation of the rupee in terms of the franc and the dollar are remarkable. A typical Indian course of exchange will be as follows:—

Indian Course of Exchange.

	March, 1918	June, 1920	July, 1922	Jan. 1930
Bank T. T. on London	1s. $4\frac{31}{32}$d.	2s.	1s. $3\frac{9}{16}$d.	1s. $5\frac{7}{8}$d
Bank Demand Draft on London	1s. $5\frac{31}{32}$d.	$20\cdot\frac{1}{2}$d.	1s. $3\frac{19}{32}$d.	1s. $5\frac{29}{32}$d.
Bank Demand Drafts on Paris	192 francs for 100 Rs.	480francs for100Rs.	340 frances for 100 Rs.	922 francs for 100 Rs.
Bank's 3 months on Paris	$198\frac{1}{2}$ francs	556 francs	350 francs	940 francs
Bank's D. D. on New York	Rs. 297 for 100 $.	Rs. $310\frac{1}{2}$ for 100 $.	Rs. 336 for 100 $.	Rs. $273\frac{1}{2}$ for 100 $.
60 Day's sight Japan	Rs. $144\frac{1}{2}$ for 100 yen	Rs.116for 100 yen	Rs.$159\frac{1}{2}$for 100 yen	Rs. $132\frac{1}{4}$ for 100 yen
D. D. on Hongkong	Rs. 213 for 100 dollars	Rs.$219\frac{1}{2}$for 100dollars	Rs. 202 for 100 dollars	Rs. $110\frac{1}{2}$ for 100 dollars
D. D. on Shanghai	Rs. 303 for 100 taels	...	Rs. 270 for 100 dollars	Rs. $136\frac{3}{4}$ for 100 dollars

216. High Exchange:—The Government of India went on raising the rate of exchange, as we have seen, in response to the rise in the price of silver and thus abandonded, for purposes of foregin exchange, the old ratio between the rupee and the sovereign, while maintaining the legal relation for internal purposes. This latter ratio was only nominal since the sovereign was at a premium and had disappeared from circulation, large quantities of it having gone to the melting pot. This policy was believed to be in consonance with the principle underlying the gold exchange standard and was defended on the ground of the impracticability of the alternative courses. It remained for the Babington Smith Committee merely to decide at what rate exchange should be stabilized, and it recommended 24d. (gold) as the most suitable rate. It stated that 'the stable relation to be established between the rupee and gold should be at the rate of ten rupees to one sovereign, or in other words, at the rate of one rupee

to 11·30016 grains of fine gold both for foreign exchange and for internal circulation. The rupee was not linked to sterling as before on account of the depreciation of the latter; but sooner or later sterling and gold were expected to attain the old parity of value. There was no novelty of principle in this linking of the rupee to gold; and in practice, it would have to be measured in terms of sterling, depreciated or otherwise.

The change from 16d. to 24d. as the gold value of the rupee, was necessary, in the opinion of the Committee, to protect the rupee from the melting pot. At the new rate, it would be profitable to use the rupee as bullion, rather than as a coin, only when the price of silver exceeds 63d. an ounce, and it was believed that as at this price the silver currencies of France and the U. S. A. are likewise threatened, 24d. (gold) was a safe rate to adopt. But 8d. was a considerable rise in exchange and the high rate was calculated to have a detrimental effect upon Indian producers and manufacturers. Though consumers and importers would benefit by the ratio of 1 sovereign = 10 Rs., cultivators and others would lose because they would receive for their commodities Rs. 10 instead of Rs. 15 for each sovereign.

The comparative disadvantage of a high rate of exchange was a subject which had been discussed by the Herschell and the Fowler Committee and they had arrived at the conclusion that a low rate does not confer any permanent benefit upon the country and that the contrary claim had not been borne out by the trade and other statistics. The change recommended by the Babington Smith Committee was rather large and it had to justify the rate of exchange it favoured. The strongest arguments it could urge, of course, were that (1) a return to the old rate was impracticable in view of the probable prevalence of a high price of silver, that (2) the undesirability of tampering with the rupee was a very serious consideration and that (3) the inconvenience and disturbance caused by too low a drop from the rate already reached had to be obviated. The Committee, however, laid great stress upon the beneficial effect upon prices and upon the population generally, of a high exchange which was for that reason, welcomed and had been urged by the Government of India.

217. High Prices and Exchange:—Besides the argument that in stabilising exchange, the least disturbing course to follow is to

adopt a rate as near as possible to the prevailing rate, the consideration that appeared decisive to the Committee, was the ameliorating effect a high exchange would produce upon the political unrest which had widely spread throughout the country. With a high exchange, a stated amount of English money in which the value of Indian exports was expressed, would be converted into a smaller number of rupees, and therefore, the Indian prices in rupees would be lower. The rupee being rated at a higher amount, importers of goods would pay smaller prices in rupees for foreign commodities, with the same result. A falling exchange had, before 1893, prevented Indian prices from going down in conformity with the declining prices of Europe. It was believed that on a parity of reasoning a high exchange would prevent Indian prices from rising in unison with the high prices ruling in western markets. The fact that the rise in Indian prices was comparatively small, was attributed to the government policy of raising sterling exchange. The Government of India very strongly favoured a high exchange on this account, and in justification for the relief that would be afforded to the consumers, pointed to the prevailing discontent which had occasionally burst out into violence and crime. The Committee attached very great weight to this plea[1] and also advanced further reasons in support of its recommendation.

It was urged that apart from the fact that if the country lost on its exports on account of fewer rupees being obtained by producers and merchants for them, it would gain on imports, the cheapness of which was an important consideration from the point of view of industrial development as well as that of the consumer harassed by high prices. The loss caused by a high exchange would be more than made good by the unusually high prices which Indian's exports commanded and would continue to command in the outside markets. Further, an analysis of the population by occupations showed that the number of cultivators and others who were likely to benefit by a low exchange, was smaller than that of those who would suffer hardships thereby. It was contended that the effects of a high or low exchange were only transitory and that adjustment between wages and prices

1. "We are led therefore to the conclusion that on economic and social grounds it is not desirable to restore a low level of exchange for the rupee under present conditions. Such a level would tend to augment prices generally and to aggravate the dangers of social and economic discontent."—Report, para 50.

established an equilibrium in a short time. Foreign competition with Indian industries was not to be apprehended and the low cost of wages and raw materials would place India in a position of decided advantage. Moreover, there would be a good deal of saving on the Home Charges; and though the revaluation of sterling securities and gold in the Currency Reserve would result in a loss, it would be wiped out by savings in a few years and a surplus would accrue to the national exchequer. The above considerations combined to lead the Committee to decide in favour of a high rate of exchange.[1]

The Committee's line of reasoning becomes intelligible when it is remembered that the primary aim it had placed before itself, was to stabilize the rupee and to prevent it from going into the melting pot, and it found no difficulty in arraying arguments in favour of the course it recommended, when the aim was to be attained at any cost. It speaks of the saving on the home charges but does not take sufficient account of the fact that it is equivalent to heavy indirect taxation of the people. And it has no hesitation in stating that if the costs of production did not respond to the fall in prices which might take place in the world's markets, the whole question of the Indian currency system should be reconsidered. Granted that the rupee weighing 180 tolas of silver th fine was not to be tampered with as the chief coin; granted that its gold value must be pitched high enough to preserve its token character and protect its circulation; granted further that a high rate of exchange had kept Indian prices at a comparatively low level and that the operation of this cause must be allowed to continue; granted again that prices in the outside markets in which Indian produce was in considerable demand would remain high for some years to come and neutralize the effects of a high exchange; granted lastly, that far from being harmful to industries and trade, a high exchange was likely to prove beneficial to the mass of the population and to the government exchequer; and the case for a rupee of 2 s. (gold) was, in the opinion of the Committee, complete.

It was only natural, after the conclusion of the war, that there should be a strong desire generally felt that government should take

1 "We are thus led to the conclusion that the material interests of India are not likely to suffer from the fixing of a high rate of exchange for the rupee and that certain impo rtant advantages will follow from such a course of action." —Report, para 54.

expert advice as regards the manner in which the currency and exchange system of the country should be rescued from the chaotic state into which it had been thrown by the abnormal conditions of the preceding five years and should be placed on a sound footing. But the Babington Smith Committee was called upon to perform an impossible task in being asked to make recommendations with a view "to ensuring a stable gold exchange standard." Where were the data on which it could proceed? How could it form an estimate of the course prices would follow in and outside India and particularly of the prices of silver? It could not but grope in darkness and rely upon powers of prophesy; and it had to admit that "present circumstances are abnormal and that it is extremely difficult to foresee future developments." The Committee unfortunately felt precluded from proposing a postponement of taking a final decision as to a definite exchange rate, as had been suggested by some witnesses, notably by Sir Lionel Abrahams. Conceding that "for the current operations of trade, stability is an important facility rather than an essential condition", the Committee recommended that the rupee should be made stable at as early a date as practicable. It was still more unfortunate that government decided to act up to the recommendations immediately though the policy involved radical changes and serious risks. The Committee took full account of the influence of exchange on prices. It is obvious that sterling obtained for Indian produce is turned into rupees at the prevailing rate of exchange and the higher the rate the fewer are the rupees for which exports will be sold. Prices of imports will be lower for the same reason. A rise in exchange, therefore, stimulates imports and checks exports, and by reducing the favourable trade balance, brings about an adjustment viz. a fall in internal prices. Exchange would thus seem to depend, in the ultimate analysis, upon the ralation between internal and external prices. But the problem is not so simple.

218. Purchasing Power Parity:—The relation between internal prices and foreign exchange has been a subject of controversy among economists. While the effect of internal price levels upon the rates of foreign exchange is generally admitted, the dispute lies between the extreme advocates of the 'balance of payments theory' and the upholders of the 'purchasing power parity theory.' The former assert that foreign exchange is governed

by the prevailing conditions with respect to exports and imports, or rather, the external claims and obligations of a nation; and the latter maintain that it is regulated by the relative price levels within and outside the nation. In themselves, the two theories are one-sided, and the confusion in the currency systems of European countries in post-war years and the rehabilitation and devaluation of their standard monies, have provided interesting tests for their validity. An understanding of these theories and an examination of the above evidence will prove useful in view of the fact that the question of the connection between the rate of exchange and internal prices, loomed large before the Babington Smith Committee and the Hilton Young Commission and has given rise to sharp difference of opinion in India. Was the comparatively high rate, either 24d. or 18d., as against the old legal ratio of 16d., justified by the external and internal price levels or had it more to do with the international balance of payments? The relevant statistics we have given in this and the preceding chapter, will throw very useful light on this problem. Price statistics and figures relating to means of payment and media of exchange, on which conclusions can be safely based and which are ordinarily available, are not reliable, particularly in India, and theories must here be applied with great caution.[1]

Among others, Prof. Cassel has elaborated his theory of foreign exchanges on the basis of the 'purchasing power parity' of the currencies of different countries.[2] According to him, it is the relative price levels in countries, and not the international balance of trade, that determine the rates of exchanges. This theory does not, however, appear to differ essentially from the usually accepted old theory of price levelling and of the trade balance. Hume and Ricardo had worked at it and it developed into the famous 'currency principle.' Goschen shifted the stress of this theory from the quantity of money circulating in a country and moving in international trade transactions, to the balance of payments between countries. War-time monetary inflation once more brought into prominence the effect of

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1 Read the excellent account of theories of foreign exchange given by K Diehl in his "Theoretische Nationalokonomie" vol. III, particularly his comment on Cassel's theory of purchasing power parity.

2 See Prof. Cassel's "The World's Monetary Problems" and T. E. Gregory's "Foreign Exchange."

increased currency circulation in a country upon exchange, and purchasing power parity theory appeared to give a more satisfactory explanation of the disturbed and depreciated exchanges of the world. Owing to disturbed economic conditions, the aftermath of war, currencies of several countries were depreciated in varying degrees and the precious metals did not play their normal part in liquidating international indebtedness. Cassel's theory only emphasises this aspect of the situation of the world's exchanges without falsifying the old foreign exchange theory. What really happens is that the equilibrium of payments between two countries is effected at a certain relative level of prices in each, which determines the rate of exchange, and the latter adjusts itself to changes in the state of mutual supply and demand.[1] Exchange is kept within 'gold points' near the par in normal times by banks and governments by influencing the balance of accounts, e.g. raising of discount rate. The srerling-dollar exchange was 'pegged' by the British government in the midst of the disturbed conditions of the war-period by artificially balancing the national credits and debits at a fixed rate. When the trade balance is left to itself, however, exchange departs from the normal and registers the changing relations between the mutual demand for and the supply of national currencies. The rate of exchange will, therefore, be unfavourable, in varying degrees, to a country whose currency is depreciated, that is, whose level of prices has risen through the over-issue of paper money. The altered rate of exchange will, in this case, be the relation between the purchasing power of its currency with that of external currency, the golden link joining the two having been broken by the impossibility of moving specie. We are thus led to purchasing power parity; and it follows from this that if price levels determine the rates of exchange, these rates may be manipulated to regulate prices. Prof. Keynes, the Currency Committee and the Hilton Young Commission later, recommeded a high rate of exchange for India chiefly on this ground. And a high exchange was to be used and was actually used as a means to prevent

1 "The intervalutory exchange in all cases depends on the sum total of the transactions between two countries which entail payment in either direction. It is the expression of the monetary gap between supply and demand in respect of the foreign currency on the Bourse. The question how many marks the pound sterling is worth in Berlin depends on the balancing of supply and demand. Supply and demand arise from unsettled business obligations and speculation."—G. F. Knapp: The State Theory of Money.

prices in India from rising to the price levels in foreign countries.[1] While Cassell's theory very properly emphasises the influence of relative purchasing powers of money on exchanges, it is, however, defective in ignoring the effect of items in international balance of accounts which are independent of internal purchasing powers and which may materially affect the rates of exchange.[2]

219. Recommendations Accepted :—The Secretary of State accepted the recommendations of the Currency Committee whose report was published in February, 1920, and immediately put into operation a portion of them. Exchange was accordingly fixed at 24d. (gold), but the removal of the restrictions on the import of gold and the change in the ratio between the sovereign and the rupee so as to make it 1 : 10 for internal purposes, were postponed. The effects of this partial execution of the policy suggested by the Committee, were interesting. Instead of being stabilized, the exchange fluctuated violently from week to week. The 24d. rate in gold meant, at times, 34d. in sterling owing to the depreciation of the English pound as reflected in the dollar exchange. Speculators saw in this situation an opportunity to make profits by remitting money to London at the prevailing high rate and bringing it back when it was reduced, as it was bound to be, in course of time. There was a scramble for remittance, and foreign exchange became a veritable gamble. Here we have an interesting illustration of the 'balance of payments' theory and a commentary on Cassel's theory of 'purchasing power parity'. Having announced its determination to maintain exchange at a fixed rate, government felt itself pledged to support it by all means in its power. During the major part of 1919–20, there was a good demand for council drafts, but towards its close exchange weakened, and in 1920–21, the pendulum of the trade balance swung violently in the opposite direction. The adoption of the Babington Smith Committee's recommendations synchronised with an adverse balance of payments and an unprecedented demand for sterling remittance.

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1 Before the Indian mints were closed to the free coinage of rupees in 1893, internal prices were kept steady by a continually falling rate of exchange which counteracted the effect of higher prices ruling abroad. In 1925, the rate was raised to lower Indian prices.

2 This aspect of the problem is further discussed at the close of this chapter.

The usual method of supporting a week exchange is, of course, to sell reverse councils, and government started offering weekly remittances on its London balances which were large and which, it was believed, would be ample for meeting any demand that might be made on them. The rate that government offered for its reverse councils was higher than the market rate for remittance, and speculators fell over the shoulders of one another to secure government drafts. The demand was mostly speculative in character and government lost on its sales of sterling drafts, because it was disposing of its London funds at rates much higher than those at which they had been originally remitted. Indian money remitted at 16d. or 18d. per rupee was being brought back through the sale of reverse councils at 30 or 32d., and the difference constituted a heavy loss to the country.

This policy of government was strongly criticised. It was pointed out that reverse councils, offers of which were justified only when the trade balance was adverse to India, were being sold only to satisfy the profit-hunger of speculators in the face of favourable trade conditions and thus an unnecessary loss was being inflicted upon the country. This transaction was even characterized as 'organized loot,' and loud protests were made against it by commercial bodies. The waste of public funds accumulated in London was variously estimated and it was stated that in less than six months several crores of rupees were thus recklessly thrown away by government. The policy was, however, persisted in despite public protests, and it was only in the third week of June that some modification of it was announced. In defence of its policy, government maintained that the very fact that there was a large demand for remittances was enough to show that there were large invisible imports and that the balance of payments was adverse to India though actually the trade balance might not be so. Many of those who, during war, could not remit their profits abroad and sought sterling drafts for the transference of their accumulated savings, on the restoration of normal conditions, must be accommodated as their demand was legitimate. That there was undoubtedly a good deal of speculation involved was not denied, and government tried at one time to distinguish it from legitimate dealings and to discourage it. Government's offer of reverse councils amounted to one million £ a week but the weekly aggregate tenders were for

£ 100 million ; and government insisted upon the tenderers depositing a proportion of the price of the drafts as a sort of guarantee of good faith. Till 5th February, 1920, reverse councils had been sold at the rate of 2s. 4d.—a rate fixed for the sale of council bills. With effect from that date, however, following the recommendations of the Currency Committee, the rate was founded on the ratio of 1 sovereign=10 rupees, allowance being made for the depreciation of sterling compared with the dollar in accordance with the current dollar-sterling exchange. The divergence between the market rate and the rate at which reverse councils were offered, however, continued, and government did not see its way to stop the weekly sales.

220. Reverse Councils:—Why was the market rate of exchange lower than the government rate ? And why did government offer more sterling for a rupee than could be obtained in the open market ? The answer is that in order to give full and faithful effect to the 2s. (gold) ratio, government had to put its rate at a level which was based upon the sterling-dollar exchange while the demand for remittance not being satisfied with the supply even when supplemented by the reverse councils of government, the market rate of exchange naturally tended to decline. Between 7th April and 14th September, 1920, government sold 1[illegible] crores tolas of gold to the public at an average rate of Rs. 22 per tola with the object of making the new exchange ratio effective. But as soon as the sales ceased, the price of gold again shot up. The retention of the control over the imports of gold, the acquisition of the imported gold at rates dependent upon the sterling-dollar exchange and the continuance of the old ratio, for internal circulation, between the sovereign and rupees, had all to be abandoned at last as the result of the illicit import of sovereigns which were smuggled across the borders and of the continued wide divergence between the market rates of exchange and the parity with gold. As from 21st June, 1920, the restriction on the imports of gold bullion and foreign coin was removed. It was also declared that until further notice, the sovereign would cease to be legal tender though during a moratorium of three weeks it would be accepted at the rate of Rs. 15 at currency offices and that the currency law would be amended so as to establish the new ratio of Rs. 10 to the sovereign. Restriction on the import of sovereigns was to be removed on the expiry of the moratorium,

The sale of reverse councils was not, however, stopped but the rates at which they were to be offered were lowered to 1 shilling 11 $\frac{19}{32}$d. per rupee for immediate and 1 shilling 11 $\frac{11}{16}$d. for deferreds. The reason given for this change was the fall in the market rates of exchange which not only departed from gold parity but fell below the parity of 24d. which government would have to maintain, when the parity between gold and sterling was restored. The plea was unconvincing, and the change in government's policy meant its inability to keep up the exchange at the fixed rate of 24d. (gold) which would have been equivalent to about 28d. (sterling), at the current rate of exchange between England and U. S. A. Government admittedly gave up the struggle in despair and contented itself only with offering reverse councils at a little higher than the market rate, particularly as it happened to be the rate at which sterling drafts would have to be sold when, with the rupee valued at 24d. sterling returned to its normal value. This policy did not mend matters; there was still a divergence between the government rate of exchange and the market rate, amounting to 3d. per rupee. The highest market price for T.T.s on London was 28d. in April, 1920, 25d. in June, and 22d. in September, and it declined to 20d. in November, to 18d. in December, to 16d. in January, 1921 and to 15d. in March, 1921. During the next year the rate sank to 14 $\frac{15}{16}$d. and there was a net export of gold. In 1920–21, the total value of gold imported on private and government account, amounted to Rs. 23½ crores, the bulk of it having been brought into the country during the first eight months of the year. During the second half of the year, there was an export of over Rs. 20 crores worth of gold, which was far in excess of that of any previous year! A large portion of gold purchased from government was resold by the public at a profit for export. It was believed, in view of expected developments, that the cirumstances in which the Currency Committee had made its recommendations and the continuance of which it had made the basis for the high rate of exchange proposed, had entirely changed and that another inquiry had become necessary.

This was admittedly a disastrous instance of the failure of the exchange standard due to the insufficiency of sterling resources to convert internal into external currency so as to bring about the appreciation of the rupee. Two years previously, the scheme had proved unworkable through government's inability to supply the

quantity of rupees demanded; it was now the other way round. In the first case, the reservoir of currency circulation could not be fed with a sufficiently large inflow of funds through council drafts and the imports of treasure; in the second, outflow was not effective in draining off the superfluous currency which sought conversion into gold. In short, the mechanism would not function with efficiency and the sale of £ 55 millions worth of reverse councils did not produce the desired result. It is worthy of note that the Gold Standard Reserve Fund, the chief support of the whole system, was not brought into requisition at all, and the burden of supporting exchange was thrown upon the tax payer. [1]

221. Persistence in ill-advised Policy:—The impracticability of maintaining the exchange at a fixed rate in circumstances which were not favourable to the success of a gold exchange standard policy even on the basis of 24d. (gold), was brought home to the mind of government only after a futile but costly experiment had been tried and the lesson had been learnt that the sole remedy for the situation was to leave the exchange to take its own course. The various steps taken by government to give effect to the recommendations of the Currency Committee, have been described in the last chapter; and it will have been seen from that account that though necessary and important in themselves, as required for withdrawing all restrictive measures and for restoring normal conditions, they failed to attain the principal object aimed at viz. the stabilization of the exchange at the proposed or at any rate. Instead of bringing order and stability out of the prevailing chaos, government only succeeded in further confounding the confusion and in incurring a heavy loss. It will not be uninstructive to direct attention to some of the prominent features of the trade and the industrial situation in the country and outside at the time and to the manner in which it reacted upon the exchange policy.

The close of the war saw India on the eve of an anticipated industrial and commercial boom. A wave of unpre-

1 The Author was able, by moving a resolution in the Council of State, in March, 1922 to secure from government a full statement of the real, as distinguished from the apparent or 'accounting' losses and gains which had accrued since 1917-18 as a result of its general working of the currency system and particularly, of its exchange policy. The net loss was admittedly heavy and worked out at about Rs. 25 crores. Some of it would be recouped when gold and sterling securities in the Currency Reserve were revalued.

cedented prosperity appeared to be in sight, profits made and accumulated during the course of four or five years, were awaiting investment and remittance and preparations had been in progress for industrial expansion. Embargoes on import and export were being lifted and restrictions were being removed on all sides. It was believed that the high prices and large profits of the war period would continue while arrears of famished consumption were being made up all the world over. As many as 905 new joint stock companies were registered in India in 1919–20 with an authorised capital of 275½ crores; and the corresponding figures for the next year were 966 and 146 crores. During 1919–20, India was wafted on the rising waves of prosperity in foreign trade. Indian exports increased monthly from 22½ crores of Rs. in April, 1919 to the record figure of 31½ crores in March, 1920. Imports also showed a similar upward movement, having risen during those months from 14½ to about 24 crores. The total trade of the year reached the record figure of Rs. 535 crores. The high tide of exports, however, soon spent itself as the purchasing capacity of foreign nations was unequal to the digestion of our supplies and prices were on a declining grade. But the imports which consisted of the goods ordered in anticipation of the expansion of existing business activity and of new industrial enterprise, continued to pour into the country. During 1919–20, the upward movement of exports and imports was almost parallel; in the next year, the two currents diverged widely from each other. The exports which had fallen to Rs. 28½ crores in April, 1920, declined to 22 crores in September and to 18 crores in March, 1921.

The results of the above movement of the export and the import trade of the country was that while the year 1919–20 showed a favourable balance of 119 crores in private merchandise, the next year had to record an excess of imports of over 79 crores! The favourable private merchandise trade balance during five years before the war showed an annual average of 78 crores of rupees. This annual credit balance was only slightly reduced to an average of 76 crores during the five war years ending in 1918–19, the reduction in quantities being made up by an increase in values. The next two years witnessed a remarkable rise and fall, breaking all past record, both in excess and deficiency of exports. The position will be found to be neatly summed up in the following passage :—

"The year 1919–20 was a period of high prices and of feverish activity in trade. In India, the monsoon of 1919 had been unusually good and al-

though the high level of prices necessitated the continuance of control over the export of food stuffs, the year's trade established a record for the value of exports and imports alike and also a record figure for the excess of the former over the latter. Conditions in the year 1920–21 were very different. The monsoon of 1920 was unfortunately below the average, particularly in North-west India and in parts of the Deccan.......The trade boom which succeeded the Armistice proved to be short-lived. It was realized that the reconstruction of the shattered finances of the greater part of Europe and the restoration of her purchasing power was to be a far longer and more difficult process than had been generally supposed. Throughout the world the year had been a period of disillusionment, of falling prices, of restriction of credit and of increasing unemployment. In India the consequences are seen in the stagnation of her export trade through the falling off in the purchasing power of her principal customers, and in the crippling of many of the new companies which were started in the brief period of prosperity. At the same time her difficulties have been intensified by the phenomenal fall in the value of silver, by the flood of high priced imports which were stimulated by the earlier high level of exchange, by the consequent swing of the balance of trade heavily against her, and by the failure of the Government, in the face of these adverse factors, to support exchange at the level which had been recommended by the Committee on Indian exchange and currency".[1]

222. Exchange Left to Itself:—For the first nine months of the official year, 1919–20, there was a good demand for council drafts, and altogether 24½ crores of these were sold by the Secretary of State; but during the next few months, the position was entirely reversed, and reverse councils for a large amount had to be offered for weeks together. The steadily rising price of silver, coupled with the demand for rupee drafts in London and for rupee currency in India, compelled government, for the greater part of 1919–20, to push up the rate of exchange successively; and then came a decline and the final collapse. The market rates varied as follows, the rates offered by government being higher, as will be shown below—

Market Rates of Exchange

Date	Rate for T. T.	Date	Rate for T. T.
1st May, 1919	...17·9d.	15th December, 1919	...28·9d.
15th May, 1919	...19·9d.	1st February, 1920	...32·5d.
15th August, 1919	...21·9d.	1st March, 1920	...31·0d.
1st October, 1919	...24·2d.	15th March, 1920	...27·7d.
15th November, 1919	...24·7d.	1st May, 1920	...24·5d.
1st December, 1919	...27·1d.	15th June, 1920	...22·0d.
		15th October, 1920	...19·0d.

1 Report of the Currency Department for 1920–21.

In January, 1920, the demand for sterling transfers sprang up, and reverse councils began to be offered weekly. There was an atmosphere of uncertainty and speculation about the immediate future of the exchange and the recommendations of the Currency Committee were expected to appear every day. The demand for sterling drafts was many times larger than the quantities offered by government with the object of keeping up the rate of exchange. In February, government committed itself to the new policy of a 24d. gold rupee, and accordingly, the rate for immediate transfers at the sale on 5th February, was fixed at 2s. 8d., allowance for the depreciation of sterling in relation to the dollar being included in the figure. In the following week, the rate was raised to 2s. $10\frac{27}{32}$d., but by 1st April, it was reduced to 2s. $4\frac{13}{16}$d. The trade balance which was favourable in the first two months of the official year 1920–21, became adverse in June, and it remained so to the end of the year and during the whole of the next year. It was consequently impossible to bolster up the exchange any further. The sale of reverse councils of 28th September, 1920, was the last in what turned out to be a disastrous gamble and government retired from the money market discomfited. The following statement brings out this feature in an instructive manner :—

Course of Trade and Exchange

Excess of Exports=(+)
Excess of Imports=(−)

		(In crores of rupees.) Imports.	Exports.			Rate of Exchange (In pence)
April,	1920...	22	28	+6	...	26
May,	1920...	24	28	+4	...	$27\frac{3}{8}$
June,	1920...	26	23	−3	...	$25\frac{1}{4}$
July,	1920...	28	21	−7	...	23
August,	1920...	31	20	−11	...	$22\frac{3}{4}$
Sept.	1920...	29	21	−8	...	$22\frac{1}{2}$
Oct.	1920...	32	21	−11	...	$21\frac{3}{8}$
Nov.	1920...	32	19	−13	...	$20\frac{1}{2}$
Dec.	1920...	32	20	−18	...	$18\frac{3}{8}$
Jan.	1921...	31	19	−12	...	$18\frac{1}{8}$
Feb.	1921...	25	18	−7	...	$16\frac{3}{4}$
March,	1921...	24	18	−6	...	$15\frac{11}{16}$

The highest rate at which sterling drafts were offered was 2s. 10d. on 12th February. The demand for foreign remittance being appreciably in excess of the supply, the difference between the banks' exchange rate and the rate offered by government on the basis of the sterling-dollar rate to make the policy of the 24d. gold rupee effective, was at times as high as 3 or 4d. The appetite for remittance grew with the large quantities absorbed by the public, mainly as speculative transactions. As has been indicated above, the balance of trade which was so conspicuously in India's favour throughout 1919–20, however, swung to the other side in June of the next year, and with decreasing exports and steady imports, the demand for remittance abroad dragged the market rate of exchange down to 22d. in that month. By the middle of June, 1920, government had sold sterling remittance of the value of £40 millions in the course of 6½ months without succeeding in making the new exchange rate effective. The price of silver was also slowly declining. The average price per ounce was 64½d. in April, 1920, 44 d. in June, 57d. in August and September and 38d. in December. It went down so low as 30d. in March, 1921. As a result, at the sale of reverse councils of 24th June and at subsequent sales, the rate adopted for telegraphic transfers was 1s. 11d, this being the rate which would ultimately hold when sterling returned to parity with gold.

Owing to the unfavourable balance of trade, however, there was a progressive fall in the market rate, and the applications for government remittance continued to be enormously in excess of the weekly supply. From 15th January to 22nd April, 1920, £2 millions were offered weekly and the amount was reduced to £ 1 million thereafter. The amounts applied for averaged about 110 millions in July and 120 millions in September. "At the end of September sales of Reverse Councils since the beginning of the year had totalled £ 55,382,000, and the note circulation between 1st February and 15th September had been reduced from Rs. 185 crores to Rs. 158 crores. But even this substantial withdrawal of currency proved ineffective to maintain exchange in view of the abnormal activity in the import of foreign goods and the absence of any support from exports. The Government of India, therefore, decided, after the sale of 26th September, to withdraw, for the time being, their offer of sterling drafts on London. During the remainder of the

year no further sales were made and the exchange value of the rupee, deprived of this support, rapidly declined."[1]

223. The Aftermath :—It is not possible to justify the sale of reverse councils even at a lower rate after June when the futility of all efforts to attain and maintain a high exchange had been fully demonstrated. There was a lingering hope, it appears, in the mind of government that it would be possible to keep up exchange when sterling returned to the gold parity ; or it could not withdraw without a loss of prestige from a policy deliberately adopted. In any case, it was not prepared, at the time, to acknowledge that the exchange standard had utterly failed and went on with it till its sterling resources were exhausted. When in 1918 the gold import point and the bullion par of the rupee had been exceeded by the rate of exchange, government stoutly refused to sell councils at a loss. But only two years later, it offered reverse councils with a lavish hand to all speculators who came along, though this misplaced munificence was equally unbusinesslike and ruinous. The country had to pay a heavy price for this undoubting faith of government in its power to fix the exchange. The depreciation of its gold and sterling assets, converted at an impossible rate into rupees, entailed a huge loss on the public treasury and caused financial and commercial confusion. Government's exchange policy had created in the public mind an impression that the sterling value of the rupee would be maintained at a high rate. Goods had been ordered in anticipation of this prospect, and when they actually arrived, it was found imposssible to take delivery of them as in the meanwhile the exchange had hopelessly collapsed. There was a good deal of friction between importing houses and Indian dealers who had ordered out goods, and it only strained the relations of Indian merchants with Lancashire. The waste of public funds caused by the attempt to make the 2s. rate effective and the orgy of speculation it gave rise to, had a demoralising and chilling effect upon the trade, industries and finances of India, and it took the country five years to recover from the shock it had received.

The universal condemnation of government's exchange policy, evoked an elaborate defence from the Finance Member. In his

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1 Report of the Currency Department for 1920-21.

speech explaining the financial statement for 1921-22, Mr. Hailey referred to the effects of the economic depression that prevailed all the world over on the situation in India and attempted to demonstrate how, under the peculiar circumstances in which government was placed, the measures adopted by it were perfectly natural and reasonable. Regarding the complaint of importers that they had suffered from government's failure to support exchange, he stated :—"It was impossible to say what variations might take place in the rupee-sterling exchange. Ordinary commercial prudence should have led merchants to cover their exchange. Common commercial morality should at all events prevent those who desire to dishonour their contracts from pleading so unsubstantial an excuse as the failure of government to make its policy good. I can imagine no severer blow to the international credit of India than that there should be a general movement on the part of some sections of our merchants to announce a policy of general repudiation." Admitting the force of the agrument against the policy of the wholesale repudiation of their contracts by Indian importers, that it was opposed to universally recognized canons of sound and straight business dealing, one can not help feeling that it did not, by any means, absolve government from its responsibility to maintain the rate of exchange it had itself fixed and attempted to keep up, and to make effective the exchange standard it had established in the country. British manufacturers were in a hurry to unload their accumulated stocks in the Indian market and the importers on this side did not cover their exchange and relied upon government's ability to give effect to its declared policy. Of what value is the exchange standard, it was legitimately asked, if it fails the trading communnity in a time of such difficulty as is anticipated and sought to be met by its machinery? Still the shock of the breakdown was too severe to dispose government to take up the suggestion that it was essential that a permanent solution for the problem of Indian exchange should be found in the near future.[1]

224. Fresh Inquiry Inevitable :—The five years which elapsed after the abandonment of the effort to sustain a fixed rate

1 Read the proceedings of the Council of State where the Author raised a debate on this subject in September 1921. Read also a statement prepared and issued by government at his instance and showing the gains and losses due to its exchange policy. On its own showing, the net loss to the country of all transactions of government ralating to silver, gold and exchange, and including earlier profits, exceeded Rs. 25 crores.

of exchange by means of reverse councils, were uneventful; and 'once bit twice shy' may aptly describe government's attitude. The country slowly recovered from the post-boom depression of 1920–21. The balance of trade, still unfavourable in 1921–22, became increasingly favourable in the succeeding three years, as will be seen from the following table :—

Balance of Trade

(In crores of Rupees)

	1922–23	1923–24	1924–25
Exports of merchandise ...	+314·32	+361·24	+398·36
Imports of " ...	−224·31	−217·88	−243·18
Balance in merchandise ...	+90·01	+144·3	+155·18
Gold	−41·18	−29·19	−73·78
Silver	−18·17	−18·38	−20·06
Currency Notes	− ·91	− 1·08	−·28
Balance of transaction in treasure. ...	−60·26	−48·65	−94·12
Total visible balance ...	+29·75	+96·23	+61·06
Council bills, purchase of sterling and other government remittances ...	− 7·06	−33·39	−56·35

The above figures represent a progressive growth of the trade balance in India's favour; and the gap between the merchandise exports and imports in 1924–25 is as large as Rs. 155 crores. The latter fact is accounted for by the comparatively higher prices prevailing in external markets; and the trade balances also received increasing assistance from remittances through government operations, as much as Rs. 56 crores being provided in that way in 1924–25. The average rate of exchange slowly crept up and settled down in the neighbourhood of 18d.; government remittances were largely instrumental in preventing a further rise. The development of the

rupee-sterling ratio and rupee-gold ratio is shown in the following table :—

Course of Exchange.

Year and Month	Calcutta–London Exchange	
	Sterling s. d.	gold s. d.
1920 January	2 $3\frac{7}{8}$	1 10
1920 December	1 $6\frac{3}{8}$	1 $1\frac{3}{16}$
1921 December	1 $3\frac{7}{8}$	1 $8\frac{5}{32}$
1922 December	1 $3\frac{31}{32}$	1 $2\frac{27}{32}$
1923 February	1 $4\frac{1}{8}$	1 $3\frac{5}{8}$
1923 December	1 $5\frac{1}{32}$	1 $3\frac{3}{8}$
1924 December	1 $6\frac{1}{32}$	1 $5\frac{3}{16}$
1925 December	1 $6\frac{5}{32}$	1 $6\frac{1}{16}$

While the current rate of exchange appeared to hover round 1 s. 6d., the statutory rate still stood at 2s. As the accounts of government continued to be kept on the basis of this fictitious rate and the actual rate at which money was remitted to London was much lower, a normal deficit on that account had to be shown in the financial statistics. Moreover, as imported sovereigns could not be presented at currency offices and converted into money, an automatic and imperceptible check was imposed on the increase of currency circulation and on the tendency of the rupee to fall. Objection was taken to this procedure of indirectly starving monetary supplies, of deflating the currency and of keeping the exchange at a high level to the disadvantage of producers and exporters.[1] If it was stated in reply to this that ample provision had been made to issue emergency currency to meet seasonal stringency, the rejoinder was made that whereas the conversion of imported gold and sovereigns into notes and rupees would have made a real addition to the circulation under

1 Read "India's Exchange Problem" by B. F. Madon.

an effective ratio of exchange, the above temporary measures of government were only a delusive palliative which facilitated deflation and the raising of the rate of exchange. In fact, the high visible balance of trade in India's favour which was Rs. 60·7 crores in 1924–25 and Rs. 109·5 crores in 1925–26 and which had stimulated rise of exchange, dwindled down to Rs. 39.9 crores in 1926–27 and consequently weakened the exchange in the latter year. Government could remit very little to London in the usual way by purchasing sterling in India and had, on the contrary, to sell sterling (reverse councils) to the extent of £ 1·4 million. Remittances to the London treasury had consequently to be made by transfers through the Currency Reserve, and Rs. 23·4 crores were made available in this way. "As the sterling in the Paper Currency Reserve was nominally valued at Rs. 10 to £ 1, remittance at this rate would have unduly weakened the reserve, so that rupee treasury bills in the reserve in India were also cancelled to readjust the balance. This was made possible and desirable......by the redundancy of currency and the return of rupee coin from circulation."[1] The fear was, therefore, expressed that every thing pointed to government's intention to manœuvre into a position in which an 18d. or 20d. rupee might appear to be a reasonable proposition. Efforts were made in vain to secure the fixation of the currency ratio at 16d. as of old, private bills in that behalf being submitted to the central Legislature. After putting off an inquiry on the ground that it was premature owing to unsettled world conditions in the domain of finance, industry and trade, government at last promised early in 1925, the appointment of a committee late in the year to advise as to the rate of exchange, if for no other purpose.

225. Questions at Issue:—A fresh investigation was, of course, bound to oover the whole of the ground which had been traversed in the course of the two preceding inquiries. The two Reserves would again have to bulk large in the discussion and the question of transferring more functions to the Imperial Bank of India e. g. the management of the paper currency and the remittance of funds on behalf of government would have to be added to the terms of reference. The substitution of the full gold standard for the exchange standard, with a note issue based upon gold, would

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1 Report of the Controller of the Currency, 1926–27.

have to form an important subject of investigation on which an authoritative pronouncement would be expected. The old controversies in this regard would, of course, be fanned into flame. According to some, there was essentially little diffierence between the modified gold standard system of Great Britain and the arrangements which were in successful operation in India from 1899 to 1917. Under the former, a free gold mint, the encashment of notes in gold coin and the freedom to export gold were practically non-existent and the stability of the sterling-dollar exchange was not automatic but 'managed'. They would, therefore, be content if the exchange standard wes reestablished in India on secure foundations. The monetary ratio would, however, still remain a matter of dispute between the supporters of the 16d. rupee which was disturbed by war conditions and the advocates of a higher level of exchange.

The divergence of opinion found illuminating expression in the debates of the Indian Legislature in the budget session of 1925 and the views put forward by Sir Basil Blacket in Bombay in July of that year. The Finance Member devoted a part of his speech made in introducing the financial statement, to a pungent criticism of those who had been calling for the fixation of the rupee at 16d. gold. He saw behind this demand the hoary fallacy that "a high exchange benefits the importer of goods from abroad and a low exchange benefits the primary producer and exporter" and dealt heavy blows to that misconception and its implication. Sir Basil was careful to admit that the fallacy had grown out of the truth that "in a period of rapidly rising exchange there may be some temporary tendency for exports to be checked and imports stimulated," and added that "when, as has been happening in the last 12 months, world prices have been moving up outside India and a natural stimulus has thus been given to the world's damand for India's produce, the effect of a rising rupee exchange has been in the main to keep rupee prices from rising in sympathy with world prices." This is a sound, scientific exposition and illustration of the theory of purchasing power parity which has been discussed in an earlier section, but it is not, in any case, quite relevant to the consideration of the question of the permanent fixation of the rupee-gold exchange, and the Finance Member himself wanted to leave the question open for the time being.

He, however, did address himself to the wider aspect of the problem of prices and exchange and walked on to weak ground

when he questioned the justice and the wisdom of a policy of deliberately lowering the value of the rupee to 16d. in the face of what he described as the operation of "the natural causes connected with the world movements of trade and exchange" which had tended to raise the ratio. The obvious rejoinder to this would have been that the very existence of an artificial ratio of 2s. on the statute book had checked the operation of natural causes, and combined with government's deflation manipulations, had pushed up the exchange to 18d. The reciprocal relations of a high rate and the interests of the producer, the consumer, the government treasury and the tax-payer have been a subject of animated controversy since the closing decades of the last century; and there is no denying the fact that the transition to a high exchange rate is unfavourable to the producing classes and a serious trial for the struggling manufactures of the country. It may be justly urged that 16d. had become a natural rate of exchange in India and that economic activities, and particularly manufacturing enterprise, had settled down on that basis. It is an undeniable fact that a higher exchange had proved a serious handicap to indigenous industries by providing an indirect bounty to their foreign competitors, and its advantage to the mass of the population in India, whose consumption of imported goods is negligible, is problematical. Further, prices in the outside world might decline, justifying a lower rate of exchange; and persistence in a high rate in the circumstances, would prove harmful to producing classes.[1]

It is by no means easy to strike an exact balance between the various interests affected by the rate of foreign exchange. The Government of India was, at one time, disposed to hold that high prices in this country, induced by the rising price level outside, and attributed by its critics to government's currency policy of token rupees, were a natural effect of active international intercourse and were, on the whole, beneficial to the mass of the Indian population. The same government veered round to the opposite view and now regarded high prices in India as an evil that ought to be combated by the manipulation of the rate of exchange. It may be admitted

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1 When the pre-war sterling dollar exchange was restored, the rise in the rate tended to lower prices in Great Britain and threatened the export industries which were already in a bad way.

that if the rate has to be fixed, it ought to be stabilized in such a way that the new level may cause the least disturbance to prices and the course of industry and trade. From this point of view, it is true that there is nothing sacred in the exchange rate; but it must not be forgotten that the rate determines the standard of value in the country, and as such, is sacrosanct and must not be lightly altered. If a higher ratio enables the central government to reduce taxation, public debt and provincial contributions, with one hand, it allows that government to impose a large burden on certain classes of the public with the other; and to counteract the detriment caused by a high exchange through foreign competition, it is compelled to protect indigenous industries by tariffs, bounties and subsidies.

226. The 18d. Ratio :—While it was a natural expectation that, as in Great Britain, when the monetary standard came to be fixed, the currency would be stabilized at the old rate which had been temporarily disturbed by the war, evidence was not wanting to show that the Hilton Young Commission would recommend that ratio between the rupee and gold to which government had apparently been working for some time. (It is unnecessary to add that stabilization of the rupee in relation to a definite quantity of gold meant the determination of the national standard of value and of the rate of foreign exchange.) It is on record that the Secretary of State would have liked to allow the rupee to go as high as practicable, but the Government of India was not prepared to take it above 18d. because it foresaw the difficulty of the huge deflation that would be necessary for the purpose and was consequently content with a small increase in the exchange rate over the pre-war ratio. While the inquiry as to the proper rate of exchange proceeded, the Government had thus already managed to stabilise the rupee, by its currency manipulation, and the Hilton Young Commission could do little more than sanction the ratio.[1] The principle of purchasing power parity, explained above, was applied to the prevailing conditions with reference to world prices and the price level in India in considering the most suitable rate for stabilizing the rupee.

The chief argument of the Commission in favour of the 18d. ratio was its conviction that at that rate prices in India had already

1 See Minute of Dissent by Sir Purshotamdas Thakurdas.

attained a substantial measure of adjustment with those in the world at large and that "any change in the rate would mean a difficult period of readjustment, involving widespread economic disturbance, which it is most desirable in the interests of the people to avoid, and which would in the end be followed by no countervailing advantage." In whatever manner the *de facto* rate of exchange might have been brought about, the decisive factor, in the opinion of the Commission, was the extent to which it was reflected in internal prices, and it felt satisfied, on the evidence it could collect, that prices had, to a preponderant degree, adjusted themselves to the existing ratio, and therefore, it followed that that rate must be adhered to. The Commission's line of argument was as follows :—" From December, 1922, to June, 1924, the gold exchange value of the rupee (as measured by the cross-rate, Calcutta-London-New-York) remained fairly stable round 1s. 3d. gold (the limits being about 1s. 2¾d.). During the same period the rupee price level, as measured by the Calcutta wholesale index figure remained fairly steady round 176, the limits being 170 and 181. From July, 1924 to January, 1925, the rupee rose sharply to the neighbourhood of 1s. 6d. gold, and since the end of May, 1925, it has been held within the 1s. 6d. gold points. From July, 1924 to June, 1925 the rupee price level fell from 179 to 157 and has since then varied between the limits of 163 and 153."

From this statistical evidence relating to the course of external and internal prices and of the rate of exchange, the Commission drew the conclusion that during the period of change, indicated above, "there was a mutual adjustment of prices and exchange , and that a substantial equilibrium was attained about the middle of 1925, and has been since maintained." On the principle of purchasing power parity, the rate of exchange is a gear that keeps the internal prices in a certain relation to the external price level. If the rate is raised, the world prices remaining unchanged, internal prices fall. This was, the Commission argued, exactly what the rise of the exchange from 1 s. 3d. to 1 s. 6d. had achieved in the case of the Indian rupee prices between July, 1924 to June, 1925. The fact that the movements of both price levels were parallel with the ratio steady at 18d., was a proof that a full adjustment had taken place, and if the ratio were disturbed again and lowered to 16d. as suggested to the Commission, prices in India would rise in sympathy with that fall in the

ratio of exchange. The best course to follow, in the circumstances, was to make the *de facto* ratio the legal rate of exchange and save the government and the country all the trouble and the hardship which a change to a lower exchange viz. 16d. was sure to cause. At the ratio recommended by the Commssion and finally adopted by the legislature, early in 1927, the standard of value in India was fixed at approximately 8·4 grains of gold, which was to be the equivalent of one rupee.

227. The Ratio Controversy:—The announcement of Government's decision to give legislative effect to this recommendation evoked a storm of controversy in the country which was supported by the Indian Currency League on behalf of 16d. and by the Finance Member, of the 18d. ratio. The two sides advanced arguments which were now familiar enough and liberally drew upon the armoury provided by the Currency Commission's majority report and the dissenting minute of Sir P. Thakurdas. The strongest plea of the Commission was that with the 18d. ratio prevailing for a year, a substantial adjustment of prices had taken place and that "from the point of view of contracts, as well as from that of prices and wages, the least disturbance will be caused, and the least injury will be done to all the interests concerned by adhering to the *de facto* ratio." On an examination of the position of those who urged the restoration of the 16d. ratio, the Commission was led to hold that "during a period of adjustment of conditions to that rate, certain sections of the community (*e. g.* debtors, exporters and employers of labour) would be benefited at the expense of certain other sections (*e. g.* creditors, importers and wage-earners)," but that there would be little "substantial permanent benefit even to any section at the expense of another, still less to the country as a whole." It was further pointed out that the effect of the reversion to 16d. would be disastrous to the course of foreign trade, to the labouring classes and consumers and that the change was calculated violently to disturb the financial position and prospects of government, forcing the latter to put off the remission of Provincial contributions and to resort to additional taxation. The last plea was fully exploited by the Finance Member who tried to make out that a return to the historic rate, while benefiting a small class, would usher in an era of deficits and spell ruin to the community as a whole.

Sir P. Thakurdas had vigorously combated the assumptions, inferences and conclusions embodied in the majority report of the

Currency Commission. It was a fact beyond dispute that the 18d. ratio had not been attained as a result of the working of normal economic forces, that the opportunity to stabilize the rupee at 16d. when it arrived, in 1924–25, was not availed of and that the exchange was pushed up deliberately to 18d. and held there by artificial means. It was, besides, very doubtful if the adjustment of prices assumed by the Commission had really taken place and it was certain that a fall in prices would deepen the industrial depression in India. Sir Purshotamdas was of opinion that the effect of the high rate of exchange on Indian prices had not yet exhausted itself and that a further fall was bound to come, to the serious disadvantage of the Indian producers and if the world prices went lower still (which was quite likely) the result would be disastrous.[1] The financial position of government was indeed eased by the higher ratio, but all the benefit of a reduction of Provincial contributions and of recurring surpluses in the central treasury would be purchased at the cost of an additional burden indirectly piled upon the shoulders of the cultivator and the general taxpayer. The public treasury's gain was obviously the loss of the producing classes. Government was being urged to extend protection to indigenous industries by means of import duties and bounties, and the assistance thus given was neutralized by the higher ratio which helped India's foreign competitors. The temporary benefit which accrued to consumers and the labouring classes, was bound to react detrimentally on them through the set-back received by national industries on account of reduced production and the losses resulting from it and from low prices. Every other nation has tried to revert to its old standard of value, though without success, except in two or three important cases; in India Government has deliberately worked up to a new ratio. The events which have occurred since the adoption of the 18d. rate, have conclusively demonstrated that the

1 "When it is remembered that commodity prices follow a movement in exchange, and that there is always a lag in Indian internal prices and a delayed adjustment to external factors, it must be admitted that the greater part of the general adjustment to 1s. 6d. by a fall, is still to come......If gold prices fall—and Indian prices must follow such a fall—India will be faced with a still bigger fall —the double effect of the operation of the present rate of 1s. 6d. and also the world fall. I can not but contemplate such a prospect with very serious misgivings, for it will hit the Indian producer to an extent beyond his capacity to bear."—Minute of Dissent.

assumed adjustment of prices to the ratio was a myth and that considerable deflation and the resulting monetary stringency as also temporary borrowing in London were necessary to prop up the exchange.

228. Position Critically Examined :—It was believed in certain quarters that the serious difficulties experienced in maintaining the high ratio, joined to the prolonged industrial depression which prevailed in the country, particularly in the cotton mill industry in Bombay, would induce Government to respond to public opinion and to revert to the 16d. exchange, but the Finance Member, on return from England towards the close of 1929, shattered these hopes by declaring that no change was contemplated. This was perfectly in keeping with the previous history of the Indian currency system. The danger of the devastating disturbance and uncertainty which a change would involve, was an obvious argument in favour of the *status quo*, and Sir George Schuster defended his policy by stating that any other currency authority, placed in similar circumstances, would have acted precisely as the Indian government had been doing. Taking the monetary and financial conditions in India and outside into account, he thought that what was called Government manipulation, was nothing more than the ordinary method of exchange control exercised by a national banking and currency authority. Leaving aside for the moment that aspect of the problem which relates to deflation, monetary stringency, government borrowing and the bank rate, we shall proceed to examine critically the question of the adjustment of the exchange ratio and the levels of external and internal prices on which so much stress had been laid by the Currency Commission in recommending the 18d. exchange. The Commission was conscious of " the imperfections of the Indian figures of prices," of the risk of assuming that " changes in the prices of goods entering international trade have been followed by similar changes in the prices of all other goods " and of the limitations of the purchasing power parity theory which 'can in fact supply a very approximate guidance only' and whose 'practical utility is of a very strictly limited character.' Nevertheless, it used the Indian figures of prices and the theory for all they were worth in supporting the 18d. ratio.

The figures and the arguments which led the Commission to conclude that a substantial equilibrium between exchange and prices

had been attained by the middle of 1925 and been maintained for nearly a year,[1] have been given above. It had no doubt on this point and in reply to critics who said that the adjustment was not complete and that a further fall in internal prices was still to come, the Commission maintained that "although the rupee did not definitely reach 18d. gold till June 1925, it had, between July 1924 and January, 1925 already traversed more than 80 per cent. of its upward journey from 15d. to 18d. gold; and that before June 1925 there had already taken place a heavy fall in rupee prices in relation to world prices which may be regarded as the complement of the steep rise in exchange." Now, how did prices and the exchange behave during the 3½ years which followed the publication of the Commission's report? We give below comparative figures for British and Calcutta prices :—

	British Wholesale Prices[2] Average, 1913=100	*Wholesale Prices in Calcutta*[3] Average, July, 1914=100
Average, 1924...	166·2	173
" 1925...	160·9	159
" 1926...	149·4	148
" 1927...	143·7	148
" 1928...	140·9	145
November, 1928...	136·9	146
October, 1929...	129·6	140
November, 1929...	126·9	137

As according to the Commission's showing, Indian prices had been almost completely adjusted to world prices at the 18d. exchange in 1926, it can not but be expected that a fall in the latter prices must be followed by a similar if not an exactly equal fall in the level of prices in India, and this was indeed one of the main arguments of Sir Purshotamdas against the high ratio. But what do the above figures show? In 1926, the index number of British prices and the Calcutta index number are nearly the same. Twelve months later, there is a fall of nearly 4 per cent. in the former, and the Calcutta figure remains unchanged. Then, during the next two years till October, 1929 there is a further fall of over 10 per cent. in British prices,

1 "When exchange remains steady over a fairly long period it may ordinarily be inferred that there are no differences to be adjusted"—Report.

2 The Economist, December 7, 1929.

3 The Indian Trade Journal, November 28, 1929.

and the Indian prices fall by only 5½ per cent. If 1926 be taken as 100, the figure of the British index number for November, 1929 works out at about 85 and the Indian figure for November, 1929, which is the lowest for years, will be about 92 which means that while British prices have declined 15 per cent. during the last three years, Indian prices have fallen only 8 per cent. Can it be claimed in the face of these figures that a complete adjustment has taken place between internal and external prices at the 18d. ratio? It will obviously be no argument to say that had it not been for that ratio, Indian prices would not have fallen even to the extent to which they have done. And a rapid fall in commodity prices is, after all, not an unmixed blessing. On the contrary, it will be relevant to suggest that the 18d. exchange was not suited to and justified by the prices and the general economic conditions of India. It had been pointed out that wages and costs of living had not been and might not be adjusted to the new ratio which was, therefore, bound to hit hard the cultivator and the manufacturer directly and the community indirectly but equally effectively. The prevailing industrial depression and labour unrest go to vindicate that position. But the Commission was carried away by its mathematical calculations of purchasing power parity and was too dogmatic to suggest (as its immediate predecessor had done) that the question might be reconsidered if its own expectations about price adjustments were not fulfilled.

It is worth while considering here if under the influence of the purchasing power parity theory, the importance of the causal relation of prices to exchange has not been exaggerated. Though it can not be denied that the purchasing power of money, reflected in the level of internal prices, indirectly affects the rate of foreign exchange, the factor that directly and decisively influences that rate, appears to be the balance of international payments. Apart from the doubtful value of the Indian index numbers of prices, the causes that affect prices vary in different countries, and a comparatively higher level of internal prices, is not necessarily accompanied by a relatively unfavourable rate of exchange. As has been well put, a person obtains foreign exchange not to purchase commodities with it but to discharge his obligations of one kind or another to people abroad.[1]

1 See Karl Diehl's "Theoretrische Nationalokonomie," Vol. III, and also Wolfgang Heller's "Die Entwicklung der gonndprobleme der Volkswirtschaftlichen Theorie."

How much he must pay for the external currency, depends on the state of the exchange market and not upon the price level in foreign markets. This theoretical interpretation is supported by several illustrations given in this chapter e. g. the failure of a high rate of exchange to bring down internal prices in 1920 owing to the unfavourable character of the balance of international payments and similar weakness of exchange in later years, the rise in exchange resulting from a prosperours export trade and the divergence between the curves of external and internal prices. The 18d. ratio is far from effective on account of lack of support from the international balance of payments. The latter has reference not only to the ordinary trade balance but the balance of account which includes all the invisible imports and remittances made in an indirect manner e. g. export of capital for investment abroad. The continued return of rupees from circulation and currency deflation carried out by government during the past few years and also the dull state of external trade and the limited supply of sterling bills are not without significance in this connection. A high rate of exchange can not, by itself, succeed in lowering Indian prices. Nor can it be maintained in the absence of a strong favourable balance of accounts. It only creates difficulties in the way of the adequate finance of trade and industry in the country and accentuates economic depression. An interesting comparison of the monetary position in the beginning of 1930 with what it was a year before, will be found in the Appendix.

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APPENDIX.

FINANCIAL SITUATION COMPARED.

(1930)

At the beginning of this New Year the monetary situation in India presents a striking contrast to the one that prevailed at the same time twelve months ago. One feels that something unnatural and artificial exists, and that conditions are made to appear something different from what they really are. The actual conditions in trade and industry do not at all warrant the present stringency in the money market.

The striking contrast in the monetary situation mentioned above can be best expressed by the following statement :—

		End of Dec. 1928.			1929	
Imperial Bank Rate ...		7%			7%	
Call Money ...		$6\frac{3}{4}$%			$5\frac{1}{4}$% (it was only $3\frac{3}{4}$% until 28th Dec.)	
Imperial Bank Cash	Rs.	11·04	crores	Rs.	15·77	crores.
„ Other Deposits	„	69·09	„	„	70·80	„
„ Public Deposits	„	5·38	„	„	6 20	„
„ Loans from the Govt. of India	„	6·00	„	„	Nil.	„
Trade Demand (Loans, Cash Credits & Inland Bills discounted)	„	55·88	„	„	36·80	„
Imperial Bank's holdings in Government Securities	„	19·03	„	„	30·42	„
Imports of merchandise (From April to November)	„	165·88	„	„	162 65	„
Exports of merchandise (From April to November)	„	220·77	„	„	214·06	„
Commodity Price Index	„	146	„	„	137	„

Representative Investments :

$3\frac{1}{2}\%$ Rupee Paper	Rs. $72\frac{9}{16}$	Rs. 68
5% Loan 1945-55	„ $103\frac{7}{8}$	„ $101\frac{1}{4}$
4% Loan 1960-70	„ $84\frac{1}{2}$	„ $77\frac{1}{4}$
Bombay Dyeing Mills	„ 874	„ 705
Fazulbhoy Mills	„ 789	„ 496
Tata Iron & Steel, Ord.	„ $79\frac{1}{2}$	„ $58\frac{1}{2}$
„ „ „ Defd.	„ 289	„ 269

Important Money Crops.

	Jute	99,56,000	Bales.	97,67,000	Bales.
	Cotton	61,32000	„	53,20,000	„
Acreage only available	Sugarcane	25,76,000	Acres.	25,35,000	Acres.
	Sesamum	54,42,000	„	33,26,000	„
	Groundnut	60,79,000	„	41,97,000	„
	Rice	8,21,26,000	„	7,67,45,000	„
	Linseed	31,24,000	„	22,58,000	„

Compared with last year as above, short-time money is cheap ; Imperial Bank Cash balance is larger, both Public as well as Other Deposits are larger, Trade demand is much smaller ; the Bank's holding of Government Securities is much larger ; foreign trade of India is more or less stationary ; commodity price index has fallen ; all forms of investments have depreciated in market value ; the total harvest in India is smaller ; and finally the necessity for the issue of currency against trade Bills is not felt, and the issue of Treasury Bills is continued.

These are hard facts, not exaggerated sentimental expressions. In the light of these facts any sane student of economics would expect plethoric conditions in the money market with Bank Rate at about 4%. And yet there is 7% Bank Rate which cannot be justified reasonably. However much one may deny it, the anxiety about the maintenance of the exchange value of the rupee is there ; it will most probably be intense during this coming summer months after the export season is over.

The Government of India issued a Sterling Loan for £ 6 millions which was fully subscribed. The Bank of England rate was lowered to 5% in December.

Trade was supplied with funds by Government payment against matured Treasury Bills. The increase in the call-money rate to $5\frac{1}{4}\%$ on the last working day in December was due to the demand for money to meet year-end bank balance sheet requirements.

The statement of the Imperial Bank as on 20th December showed the cash balance at Rs. 15.77 crores or a reduction of Rs. 10.55 crores on the previous month, mainly due to the decrease of about Rs. 8 crores in Government Deposits and a slight increase in trade demand during the month. The

Bank's investments in Government Securities stand at Rs. 30.42 crores as compared with Rs. 19.03 crores at the same time previous year.

The Statement of the Paper Currency Reserve as on 22nd December shows the Notes in circulation at Rs. 179.19 crores or a reduction of Rs. 5.06 crores on the previous month. This is partly due to the demand for silver rupees in exchange for Paper notes and partly due to the contraction of Currency against Sterling Securities.

Indian Sterling Securities have been weak on the London Stock Exchange, due to political reasons and the issue of £ 6 million Indian Treasury Bills. 3½% Paper as well as other Government Securities in Bombay remained more or less steady. Industrial scrips were slightly easy.

The commencement of heavy export season and the Government raising of their purchase rates led to an improvement in the Rupee-Sterling exchange by 1/16d. to 1/5-15/16d. for T. T. Exchange is expected to be steady until the end of the export season.

Exchange on Japan is steady at Rs. 134¾ for T. T. London-Shanghai exchange continued to decline and over the month the quotation has dropped by 1-5/8d. to 25-5/16d. London-New York cross rate has improved to 4.88-7/32 owing to decrease in the Bank of England rate, and improved monetary outlook in England.

Silver has to tell the same story over again this past month and locally there was a decline of Rs. 2¾ over the month and a fresh record for low prices was created.

On 30th November quotations were Rs. 51-5/8 for spot, Rs. 51½ for Magser (December), Rs. 51-9/16 for Posh (January) and Rs. 51-5/8 for Maha (February). Except for an occasional recovery prices continued to drop throughout the month, and on 30th Spot price dropped to Rs. 48-9/16. On the very last day of the month there was a slight recovery and spot was quoted at Rs. 48-7/8 and forward positions were almost the same.

In sympathy with London-Shanghai exchange silver quotations in London dropped to 21-5/16d. for spot and 21-3/8d. for forward on 30 December. Thus the lowest record for London silver reported in January 1903 at 21-11/16d. was broken and the 30th December quotations are the lowest during the past 100 years.

This decline in silver prices was mostly due to the developments in China. As far as India is concerned Bombay mint bars were not tendered in December settlement. An impression has of late come to prevail that the Government of India are not having bar silver to be sold immediately. It is reasonable to presume that the Government of India will not sell silver at the prevailing ridiculously low prices:—*"Cotton and Finance" for January, 1930, published by Chunilal Mehta and Co., Bombay.*

CHAPTER XIII

CREDIT AND BANKING

229. Borrowing and Lending :—Banking is so closely connected with the currency and exchange system of a country, that though it is a subject worthy of independent study, the mutual relations of the two must also be clearly understood. The discussion of the last two chapters will not, therefore, be complete unless we show in this, how banking operations, whether executed by Government or central banks, have an important bearing on the country's monetary system. This explanation will be given in a later part of this chapter. It will be recalled first how lack of adequate capital and high rates of interest prove a serious handicap to persons who undertake the work of wealth-production. The big industrial organizer às much as the small farmer and the petty cultivator, must have at his disposal sufficient means to pay for machinery and implements, raw materials and hired labour and for his own subsistence, until the act of production is completed and fructifies in the desired form of wealth. The wholesale and the retail merchant must equip himself in a similar manner until the goods he has purchased are disposed of. This demand for industrial and commercial capital or finance calls forth a supply. A division of labour and specialization of economic functions grow in each community ; and as there are persons who want the temporary use of goods and services, (or of money which easily procures them) belonging to others, there are people who have saved or collected and can spare the means of payment, of course, for a price. Money-lending has thus become a specialiszed business so useful to industries and trade ; and those who pursue it, principally deal in money, other instruments of payment and in the precious metals out of which currency and jewellery are manufactured. In the earlier stages of the evolution of money, the change of one species of currency into another, is an important function. We have seen that the village money-lender in India often lends to his debtors not actual currency, but the articles required by them. The dealers in money must have a stock of the means of payment out of which loans can be given ; and they find it profitable to take

deposits for safe custody and may utilize the latter—so far as these do not consist of articles like jewellery which must be returned in the original unaltered form—for lending purposes. The difference between the rates of interest paid for deposits and received for loans, constitutes the profit of the money-lender. Remittance of money from one place to another for his customers, is another function the money-dealer performs. This operation is executed by arrangement with others engaged in the same business and is mutually convenient to them.

The expansion of the size and the variety of the work of industrial and trade finance, raised the dealer in the means of payment—in loans and deposits—to the dignity of the banker, banking house and the modern bank. The process of evolution has resulted, in this instance, as in other economic spheres, in combination, concentration and specialization; and banks, while they have increased in dimensions, are found also to cater for the needs of particular classes in the community and restrict themselves to certain requirements of individual and collective life and of industry and trade. Banking has thus come to have its ramifications, in agriculture, domestic and foreign trade, industrial flotation, land mortgage and discount and acceptance of commercial paper. The banker collects the savings of people, who are attracted by the security and interest offered, to entrust their surplus to his hands, and he lends this purchasing power by means of advances against security, to those who resort to him for loans. By accepting deposits, he creates debts against himself and allows the creditors to draw upon him through cheques or orders to pay to a specific person. As he knows by experience that only a portion of the deposits will be demanded by his creditors at any given time, he keeps only a small amount in cash ready for payment and devotes the bulk to loans to customers on security. The device of the cheque, which is a convenient means of making a payment and is an important addition to the currency of a country, economises the use of money and enables the banker in many cases, to adjust the credits and debits of his customers, merely by making the necessary transfer entries in his books against the names of the latter. From the account of paper money given in our chapter on the currency system, the reader must have seen how notes are issued and accepted in lieu of standard money and how these promises to pay stated amounts, are only partly covered

with metallic reserves, thus allowing investment in securities and the earning of interest on a considerable portion of the total circulation. Government and banks issuing notes, thus create purchasing power or means of payment on a more or less narrow basis of cash and save so much gold and silver from being locked up in sterile currency. Bills of exchange, described in the last chapter, cheques and promissory notes are all " negotiable, " i. e. can be transferred by endorsement while they are used for making payments.

230. Creation of Credit:—The common use of the above negotiable instruments and the operations of banking generally, of course, imply an amount of "credit" or mutual trust among parties concerned in borrowing and lending transactions. Claims to internal and international money recorded on pieces of paper like bank notes and bills of exchange, which easily pass from hand to hand, are objects of purchase and sale in their special market, the exchange or money market, and bankers and brokers are the chief dealers in them. The importance of the development of modern banking lies in the widespread use it has made possible of mere paper orders and promises to pay legal money in carrying out commercial and industrial transactions in and outside one's own country and in the enormous saving in the handling of metallic money it has effected. It follows from the above that banking means dealing in credit and that it consists in the banker and the banking firm keeping money for their customers subject to withdrawal on specific conditions, or loaning money on security and purchasing and selling bills of exchange, bonds, stocks, promissory notes etc. The element of credit or faith or trust in connection with deposits and loans and the documents connected with them, is a striking feature of banking, in spite of the fact that there are pledges, mortgages and securities to supplement and support it. The producer and the exporter must wait till the prices of their goods are realized, but the banker is prepared to take the risk and the trouble of realization and gives them credit and advances to them immediately the money or the purchasing power which they badly need. Credit thus facilitates economic activities and promotes economic efficiency. The ease and the cheapness with which this service is rendered, constitute the test of successful banking. Where economic life is simple, banking is restricted to lending money or making available the goods to be purchased with it. Where small values are concerned, the loan is

without any tangible security or pledge and is only the postponement of the receipt of price or dues. When a shopkeeper gives 'credit' to his customer or a money-lender allows the debtor the use of a small amount of money, an oral agreement, a mutual understanding or a record of the transaction on his books suffices. Documentary evidence and mortgages become necessary when larger amounts and risk are involved. With the expansion of trade and industry, dealings in claims and 'instruments' of credit assume importance, and we have thus the delicate and complex credit machinery of our times evolved. The large-scale commerce and industries of our times would be impossible without the facilities which the organization of credit affords. In fact, it may be truly said that the latter has been called into being by the needs of financing expanding trade and manufacturing activity. It is a striking fact that Indian banking had reached an advanced stage of development long before the western type of banks was established in this country.

It is an act of neighbourly or friendly duty or of charity to lend the use of different forms of wealth or of money. Remuneration for this service may or may not be claimed; it will depend upon the condition of the borrower and the use he is expected to make of the things borrowed. The manufacture, sale and purchase of goods even in a community which is not industrially advanced, are recognized as legitimate acts of people who seek to earn a living thereby. Like other economic activities, lending and receiving deposits become specialized and therefore an occupation. Professional money lenders and bankers will pursue the occupation as a regular business and must secure an income from it. They borrow through deposits and lend by means of discounts. Interest will, therefore, be charged for the accommodation given to debtors; and the risk and the labour involved in the transaction must be duly remunerated. Professional banking is recognized by the community as a necessary function of social utility while ordinary money lending, especially at high rates of interest, viz. usury, is looked down upon as equivalent to taking advantage of the difficulties of the borrower. The banker, therefore, becomes a useful member of society, and usury is disapproved for its soulless and extortionate character. It is only natural that in the midst of the economic evolution that is in progress in India along western lines, there

should be a tendency for banking in this country to develop after the modern pattern. The banking systems of western countries, of course, have their special characteristics, and the peculiar conditions of India must react upon its banking in a similar way. The organization of credit is both an index and a cause of economic progress, and it will, therefore, be useful to study the subject here with a view to understand the existing conditions and the measures necessary for their improvement in India. Co-operative credit and banking will be separately dealt with in the next chapter.

231. Indigenous Banking:—Many people find it difficult to believe that even before the advent of modern joint stock banking, there were, in this country, numerous banking firms and bankers who carried on business on an extensive scale. Money lending was and is done by numberless persons of every caste and class, in towns and villages, all over the country. As distinguished from these money-lenders, however, the bankers took money on deposit, made loans and issued drafts or 'hundies.' They thus essentially performed and continue to perform to-day, almost all the functions of modern joint stock banks, and they have always occupied a high status in society. In old times, governments borrowed largely from the bankers who collected and remitted State revenues and financed the military campaigns of kings and chiefs as well as the internal trade of the country. The Delhi rulers, the petty kings and chiefs, the Peshwas and the Mahratta Jahagirdars, for instance, were heavily indebted to them, and several banking houses enjoyed great social reputation for the extent of their transactions and the honesty of their dealings. English banking, which has now assumed a vast magnitude, also began in this humble way. When the prejudice against usury disappeared, the people who were the first to take advantage of the favourable situation in England, were the goldsmiths.[1] Money lending and banking have developed in India

1 "As they had valuable property of their own to guard, people were inclined to think that what would be trusted to them was safe. Accordingly the practice of depositing money or bullion with the goldsmiths became a common one, the more so after 1640, when Charles I, then in great straits for money, had seized the bullion of private merchants left for safe keeping in the Tower...When the goldsmiths thus obtained deposits, they naturally were ready to lend at interest. Cromwell borrowed from them on the security of the taxes and paid them back when the taxes came in. Charles II continued the plan, paying the goldsmiths 8 per cent. for what they advanced."—Townsend Warner: Landmarks in English Industrial History.

along the lines indicated above. Lending money at interest is recognized as a legitimate occupation of the Vaishyas in the Hindu Dharma Shastras.[1] It is called "Kusida," and the rates of interest to be charged to different persons are also prescribed. Different species of interest and the varying modes of charging them are mentioned, and usury is clearly distinguished from the reasonable and legal rate.[2] Securities and pledges and the responsibilities of creditors concerning them as well as written documents containing evidence of debts, are mentioned in detail. Some thing like a bill of exchange or a banker's draft may be traced in the "Adesha" referred to in Kautilya's Arthashastra, and it is clear from inscriptions belonging to the centuries preceding and succeeeding the Christian era that deposits were taken by guilds, and interest was paid thereon just as it was done by banking houses of later periods. It may, therefore, be inferred that at an early date in the history of India such transactions had assumed large dimensions, and their minute and strict regulation had become necessary in India about two thousand years ago. Like other institutions and customs in India, banking and money lending have maintained their ancient forms, with the necessary slight adjustmen required by changing conditions till they are now being linked to modern banking.

The small bankers took deposits and allowed interest upon them, gave loans on the security of jewellery pledged with them, did money changing and purchased and sold bullion and ornaments. The business is being done to-day extensively in villages and small towns, all over India, where modern banking is unknown. The banking houses of a higher status have dealings on a much larger scale. They finance internal trade and remit funds from one place to another for their customers and discount the hundies of small producers and dealers. These 'shroffs' are thus bankers, pure and simple. Mahajans and other bankers very often combine trade with banking; and this is very convenient and also natural. Big commercial houses have trade relations in different parts of a dis-

1 'कुसीदं कृषिवाणिज्यम् शुल्कशिल्पानुवृत्तिभिः' —Narada, I, 46.
'पशूनां रक्षणं दानमिज्याध्ययनमेव च।
वणिक्पथं कुसीदं च वैश्यस्य कृषिमेव च॥' —Manu, I, 90.

2 "No interest must ever be raised on loans made from friendships unless there be an agreement to the purpose. Without an agreement even interest accrues on such after the lapse of half a year,"—Narada, I, 108.

trict or province and their debits and credits are constantly arising in those places. As they have payments to receive or to make from day to day, dealings in "hundies" constitute a necessary and profitable side of their business. In spite of the rapid progress joint stock banking has made during the last generation, these indigenous banking houses play a highly important and an indispensable part in the internal finance of the country. They accommodate small traders and producers whom the big banks can not reach. The 'hundi' draft is easily available and through it remittance can be most conveniently effected, and the absence of other and modern banking facilities is not felt. The operations of the modern banks are confined to the cities and towns. They relate mostly to the financing of the export and import trade of the country and to the accommodation of the urban industrialists and merchants of standing. Purely indigenous banking is practically cut off from them, touching them only occasionally at certain points.

Four different classes of people who have to do with credit and money lending, must be distinguished. (1) The shroffs who do real banking business of the modern joint stock banking type *e.g.* deposit and discount and nothing else, (2) bankers who are also traders on their own account and do commission agency business, *dalali* and *adat* and deal with cultivators, (3) sowkars or village money lenders whose chief business it is to lend to agriculturists on the security of crops and lands and ornaments and who likewise act as *dalals*, and (4) petty usurers who have dealings with needy persons with little security and charge extravagant rates of interest. Banking has been specialised in India, for centuries, by certain communities such as the Jains, Marwaris, Banias, Chetties of Madras and Bohras of Gujarat. The Pathan has now become the type of the usurious money lending class. Ordinary money lending is promiscuously done by people of all castes and creeds, though Mahomedans have religious scruples in the matter of taking interest. The Shroffs and other bankers of the higher classes are largely the depositories of the savings of their localities and provide the finance needed by traders and petty sowkars. They are very important in big cities and towns and though they are now feeling the competition of joint stock banks and government, they still predominate in internal trade at various centres, e. g. Ahmedabad. They accommodate one another and their mutual dealings are smooth and systematic. Among them-

selves they charge a modest rate of interest and their dealings are characterised by economy, efficiency and honesty.[1] The Indian shroffs have branches and business connections all over India *e. g.* Shikarpuri shroffs, and outside India as well.

232. Rise of Modern Banking:—Besides these (1) indigenous banking houses and bankers, we have to consider in India to-day, (2) the proposed new Reserve Bank as it is expected to function, (3) the Imperial Bank of India constituted out of three Presidency Banks of Bengal, Bombay and Madras, (4) the Exchange Banks doing business in this country as well as in others, (5) the Indian Joint Stock banks, (6) the Post Office savings banks and (7) the Co-operative Banks. The last of these will be fully dealt with in the next chapter. First, with regard to modern banking. "The European system of banking was introduced into India by the Agency Houses of Calcutta. These were not merely merchants and agents but also bankers who did business with merchant princes in India, planters and the civil and military service. They possessed a note circulation which was extremely beneficial to them. After the passing of the Act of 1813 which gave greater inducements to Europeans to settle in India, there was a considerable extension of banking in connection with the Agency Houses but the great commercial crisis of 1829–30 put an end to almost all these Houses."[2] Modern banking was thus an exotic planted in the Indian soil by European merchants, and like indigenous banking, it was combined, in the beginning, with the trading activities of commercial houses. Very naturally, Indians had no hand either in the organization or the management or the operations of the banks of the new type. Political and commercial conditions of the time and the nature of the business which European Agency houses and banks carried on, did not make it possible for indigenous banks to expand and later to resist deterioration.[3] Business relations of Indian mer-

1 For a detailed and instructive study of indigenous banking, read L. C. Jain's "Indigenous Banking in India."

2 Mr. Findlay Shirras : Report of lecture delivered in Calcutta in 1914.

3 "In fact, the European banks formed a class by themselves, attracting deposits and making advances, mainly in the Presidency town of Calcutta, on European lines. The indigenous bankers continued to carry on their accustomed business throughout the *mofussil*, and even in Calcutta, although on a more restricted scale."—J. Sinha : *Early European Banking in India.*

chants with the banking houses were likewise extremely limited. Their needs were satisfied with the indigenous system of credit accommodation. Banking which shares the characteristic features of the general economic conditions of the country, could not be expected to march in advance of the latter. The relative positions of modern banking and of the indigenous bankers have remained practically the same as a hundred and fifty years ago, though the former has widely expanded and the latter have declined. The development of modern banking and the industrial and commercial progress of the country are dependent upon each other.

The foreign trade of India in the early part of the last century, was comparatively small and internal exchange was facilitated by indigenous bankers. As trade, however, slowly expanded, European merchants and others directly interested in it, felt the necessity of having banking arrangements of the western type in their midst. Like the mercantile community, government also experienced difficulty in carrying on its financial operations without the assistance of a well-conducted modern bank, and the earlier efforts to found good modern banks, with the assistance of government, failed. Under these circumstances the Bank of Bengal came into being and received its charter in 1809. Of its capital, which was then £ 500,000, the State contributed £ 100,000 and government took its share in the direction of the affairs of the Bank. Indians came steadily to be associated more and more with the foreign trade of the country, that is to say, the movement of commodities between the ports and the interior, and therefore, with the business of the Presidency Banks.[1] The modern system of banking was particularly useful in the centres of foreign trade and came to be established, in the first instance, in the port towns. Calcutta gave the lead and it was followed at a distance

1 "The Presidency Bank of Bengal was opened in 1808 and received its charter of incorporation from the East India Company in 1806. The first Bank of Bombay (it went into liquidation in 1868 and a new one was formed in the same year) was established under a similar charter in 1840 and the Bank of Madras in 1843. The establishment of these banks in the other presidencies put an end to the possibility that the Bank of Bengal might become a Bank for all India. The Presidency Banks had at first a semi-official character. At the foundation of the Bank of Bengal the East India Company contributed one-fifth (the proportion became smaller subsequently) of the capital and appointed three of the directors. Up to the time of the Mutiny the office of Secretary and Treasurer was held by a covenanted civilian."—J. M. Keynes: Indian Currency and Finance.

by Bombay and Madras. These Presidency Banks were, in the beginning, semi-official institutions, and were gradually freed from State control, though they continued to be regulated by strict rules made for their management by government. This measure of State control was necessitated by the interests of the public which were involved in the management of the banks that used public money and enjoyed other facilities. The Exchange Banks, which have monopolised the financing of India's foreign trade, are non-Indian institutions which have built up business in this country in connection with its expanding import and export trade.

233. The Presidency Banks:—The relations of the Government of India and the Presidency Banks were regulated by the Presidency Banks Act of 1876 which imposed certain definite restrictions upon their business operations while it conceded to them some material and also moral advantages. Before that date the agreement with the banks compelled the government to place all the cash balances belonging to them in the hands of the Banks, with the result that there was a serious danger of government's money not being available when it was urgently required. In a despatch to the Secretary of State, dated 30th June, 1874, the Government of India wrote :—"The Bank of Bombay, accustomed to high Government balances, and relying on the maintenance of those balances, had so employed them that they were practically locked up; for had we insisted on withdrawing them more suddenly we should have done so in the face of a warning that we should produce a commercial crisis and therefore for a time the Government balances at Bombay were useless for the purpose of the Government ......We are of opinion that a Government subject to the contingencies to which the Government of India is exposed, ought not to be without a reserve and that this reserve should be in its own hands." The Government was inclined to dissolve its connection with the Banks, but preferably it proposed "to make a change in the agreements with the banks, so that instead of giving them the right to hold all the Government balances, the stipulation may be confined to engaging to pay them interest when our balances are reduced below certain amounts."

In his reply, the Secretary of State (Lord Salisbury) gave his assent to the proposal of the Government of India about establish-

ing an independent treasury system and leaving with the Presidency Banks certain minimum balances without interest and imposing by law specific restrictions upon their business operations. The Presidency Banks Act 1876 laid down restrictions as to the qualifications and number of directors, the kinds of business that they could not transact, the territorial limits of their jurisdiction and so forth. The Banks tried to get some of these restrictions removed as needless, and wanted liberty to deal in certain securities which were not allowed by the Act *e. g.* securities of State-aided Railways and of District Boards. They also wanted to be empowered to borrow outside India so that they might have access to the great store of banking capital available in London.

This and other matters connected with the powers and resources of the Presidency Banks, were topics of prolonged discussion among the parties concerned. Strong objection was taken to the Presidency Banks being allowed to pledge securities and take deposits in England and thus raise funds there. The Exchange Banks vehemently opposed the suggestions that the Presidency Banks should be allowed, when the Bank rate in India was 6 per cent. or higher, to borrow in London, that they should be permitted to deal in foreign bills under certain conditions and that they should be allowed to draw sterling drafts on London for the home remittances of their customers, subject to a limit of £200 in each case. One of the Exchange Banks, the Mercantile Bank of India, wrote to the Secretary of State:—"It would be an anomaly in State banking to find the Presidency Banks of India, which depend for their prestige and resources so largely on their State connection, turning their attention and their resources from the object of their existence—the facilitating the internal trade and requirement of India (a sufficiently wide field, one would imagine) to embark on operations of foreign exchange. It would further be a serious matter for the existing Exchange Banks, and very unfair to them if these State Banks, backed by their State support and the large amounts of public funds placed at their disposal by the State free of interest should be authorised to compete keenly, and with all the power that their privileged position gives them, with those institutions which have hitherto conducted that business to the satisfaction of the mercantile community."

The other Exchange Banks wrote in the same strain and there was a lively debate between them and the Presidency Banks. The

latter attempted to show that the apprehensions of the Exchange Banks with regard to unfair competition being set up in the exchange transactions against them, were baseless. The proposal of the Presidency Banks was favoured by the Government of India, but the Secretary of State was strongly impressed by the contention of the Exchange Banks that their interests would be injured by the proposed changes and declined to sanction even a moderate concession to the Presidency Banks, viz. 'allowing them to draw sterling bills on London for the purpose of the remittance of their customers subject to a limit of £200 in any one month on behalf of any one customer.' The discussion was brought to an end on 26th September, 1906, by a telegram from the Secretary of State in reply to one from the Government of India asking permission for the above amendment of the Act, stating :—'Your telegram dated 15th September, Presidency Banks. I regret that I can not accept your proposal.'

234. Their Business :—We shall presently deal with the question of monetary stringency and a high bank rate prevailing in India during the busy season, which was involved in the above discussion. It is to be noted here that the Presidency Banks were three powerful joint stock banks having special relations with government and carrying on ordinary banking business under certain well-defined limitations. They led in financing the internal trade of the country, and the ordinary joint stock banks followed them at a distance. They took deposits and lent on security and discounted, bought and sold bills of exchange and other negotiable securities payable in India or Ceylon. They could not borrow money outside India, nor could they deal in sterling bills. The conditions on which they might give loans were strictly laid down by law. They performed certain services for government and received remuneration for it. Government held no shares in the Banks and was not represented on the directorates. It, however, kept certain minimum amounts free of interest with the head offices of the Banks, and if the public deposits fell below the stipulated limit, interest was paid on the amount by which they fell short. Usually, government kept larger deposits with the Banks than they were expected, though not bound, to do.

In the absence of a State Bank, the three Presidency Banks together performed for the government the same functions as the

Bank of England, for instance, but on a restricted scale. The arrangement, is described in the following extract :—" Where a branch of a Presidency Bank exists, part of the Government balance is deposited in it. Similarly a part of the Government balances held at Calcutta, Madras and Bombay, is deposited at the head offices of the three Presidency Banks. The relations between the Government and the Presidency Banks in respect of the holding of balances are partly regulated by agreements with the three banks, which were last revised in 1898. The agreements provide that the Banks are to transact general business for the Government at their head offices and certain branches ; that they are to receive certain remuneration; that the Government is not bound to retain at the Banks any particular sum ; but that if its balance at the head Office of any of the three Banks falls on any day below a specified minimum, it is to pay to the Bank " interest at the lowest rate chargeable on such day by the said Bank to the public for loans recoverable on demand." The remuneration of the three Banks and the minimum balances that they are to hold for the government at their Head Offices without charging interest are as follows :—

	Remuneration per annum. £	Amount of Balance below which interest becomes payable. £
Bank of Bengal	2,900	233,300
Bank of Madras	800	120,000
Bank of Bombay	800	133,000

" The revision of these agreements is now under the consideration of the Government of India. In actual practice the Government of India is much more liberal to the Banks than is provided for in the agreements. They usually keep at the head offices of the three Banks the following amounts :—

Bank of Bengal	...	467,000*l.* to 533,000*l.*
Bank of Madras	...	A little over 133,000*l.*
Bank of Bombay	...	267,060*l.* to 333,000*l.*

On the flotation of a loan and in special cases, the amounts are increased."[1]

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1 See Chamberlain Commission's Report, Appendices.

The following table shows the position of the three Presidency Banks on 31st December for a series of years :—

Presidency Banks.

	1905 Rs. (lakhs).	1914 Rs. (lakhs).	1916 Rs. (lakhs)	1918 Rs. (lakhs).	1919 Rs. (lakhs).
Capital and Reserve ...	6,23	7,64	7,35	7,20	7,32
Deposits } Public ...	3,11	5,61	5,20	8,64	9,02
Deposits } Private ...	22,26	40,4	44,70	50,97	98,01
Cash Balances ...	8,23	20,84	17,27	17,07	26,03

The comparative position of the three Banks on 31st December of the years 1910, 1914, 1916, 1918, and 1920 is brought out in the following table :—

	1910 Rs. (lakhs)	1914 Rs. (lakhs)	1916 Rs. (lakhs)	1918 Rs. (lakhs)	1920 Rs. (lakhs)
Paid up Capital.					
Bank of Bengal	2,00	2,00	2,00	2,00	2,00
" Madras	60	75	75	75	75
" Bombay	1,00	1,00	1,00	1,00	1,00
Reserve & Rest.					
Bank of Bengal	1,75	2,00	2,13	1,89	2,10
" Madras	51	79	58	55	48
" Bombay	1,05	1,10	90	1,01	1,20
Government Deposits.					
Bank of Bengal	1,98	2,87	2,74	5,85	4,34
" Madras	72	91	1,04	1,02	2,09
" Bombay	1,52	1,83	1,42	1,77	3,50
Other Deposits.					
Bank of Bangal	16,09	21,61	21,44	23,93	34,74
" Madras	5,67	7,62	9,60	6,54	15,79
" Bombay	10,58	10,82	13,67	17,50	27,49
Cash.					
Bank of Bengal	5,14	11,70	7,73	8,94	12,21
" Madras	1,84	2,67	2,72	8,74	5,06
" Bombay	4,36	6,47	6,68	5,42	8,76
Investments.					
Bank of Bengal	3,68	6,21	7,69	7,80	9,13
" Madras	85	2,34	1,63	1,40	2,14
" Bombay	1,49	2,01	3,13	3,55	3,30
Dividend for the year.					
Bank of Bengal	14 p.c.	16 p.c.	16 p.c.	17 p.c.	13½ p.c.
" Madras	12 p.c.	12 p.c.	12 p.c.	12 p.c.	18 p.c.
" Bombay	14 p.c.	14½ p.c.	15 p.c.	18½ p.c.	22 p.c.

Besides the head offices, the Presidency Banks of Bengal, Bombay and Madras had 25, 14 and 23 branches and agencies respectively.

235. Exchange Banks:—Now to turn to the Exchange Banks. These are big European banking concerns with enormous resources, and they carry on their operations in India and over eastern Asia. For the sake of convenience they are classified in two groups according to the extent of business done by them in India, viz. (1) those of them that are doing a considerable portion of their business in this country and (2) the remaining that are merely agencies of large banking corporations doing business all over the East. The number of the latter has now increased owing to the addition of new banks such as the P. and O. Banking Corporation, the National Bank of South Africa and the Imperial Bank of Persia. At the close of the year 1913, there were 12 Exchange Banks in operation, with capital and Reserve amounting to £ 37·8 millions, with £ 23·2 millions of deposits in India and with £ 4.4 millions of cash balances in this country. Corresponding statistics for these banks, divided with two classes according to the nature of their business connection with India, for the year 1927, are given below :—

	No. of Banks	Paid up Capital.	Reserve and Rest.	Deposits.		Cash Balance.	
				Out of India	In India.	Out of India.	In India.
		£ (1,000)	£ (1,000)	£ (1,000)	Rs. (1,000)	£ (1,000)	Rs. (1,000)
(A) Banks doing a considerable portion of their business in India.	6	9,769	10,878	71,640	49,33,33	8,836	5,40,14
(B) Banks which are merely agencies of large banking corporations doing business all over Asia.	12	83,027	77,246	1,214,315	19,62,90	195,263	2,72,99

The chief among these Banks are institutions of very long standing, having been founded more than sixty years ago; they take deposits in India and outside, and with funds thus borrowed, finance the foreign trade of the country. They are in this way complement-

ary to the Imperial Bank and the other Indian banks which confine themsleves mostly to internal trade. They purchase bills of exchange drawn by exporters of produce and discount them with London banks or realise them when they mature.[1] By selling sterling drafts or remittances, they can partly recoup themselves for the outlay of funds on the purchase of export bills. Through their London offices they purchase import bills which are drawn on consignees in sterling and thus they finance import trade also. These transactions enable the banks to bring back the funds realised in London. As the value of India's exports normally exceeds that of the imports, the deficiency in import bills is made good by the purchase of council bills and telegraphic transfers and the shipment of gold and silver. The sale of sterling bills to the Government of India in this country, now relieves them of most of this kind of trouble.

Owing to stringency in the money market, in the busy season, the bank rate and the discount rate mount up very high. The exchange also rises and the Exchange Banks bring money into the country by buying the Secretary of State's drafts; and Telegraphic Transfers enable them to receive rupees from the government Treasuries immediately without having to wait for more than two weeks for the arrival of the bills. The sale of sterling bills to Government in India has the same effect. The difference between the rate of interest they have to pay on their own borrowings or de-

1 "Bills against the export trade are drawn D.A. (Documents on acceptance) and D. P. (Documents on payment). They are purchased by the banks' branches in India. The D. P. Bills are held by their London offices until they are retired or paid at maturity. The D. A. bills as a general rule are discounted, or rediscounted immediately after acceptance. They are rediscounted with the English Joint Stock Banks and the Scotch Banks or with bill brokers financed by these, and especially in times of stringency with the Bank of England. These bills may be held for a time by the Indian Exchange Banks in London. This wonld occur when business in India was stagnant or when money was difficult to employ in London. To the extent to which the D. A. bills are rediscounted immediately after acceptance (which they are in the great majority of cases) the Indian export trade is financed not with the funds of the Exchange Banks except from the time of the purchase of the bills in India to their arrival in London, but with the funds of the British Banks i. e. with British and not Indian capital."—Report on Banks in India, 1917.

posits, both in England and India, and the rates they charge in discounting sterling bills, constitutes their profit. The deposits of the Exchange Banks have considerably increased in recent years though in view of the reduced purchasing power of money, expansion in the first of the two classes of the Banks is not very great. While enjoying a monopoly of the finance of the export trade of the country, they participate actively in collecting internal deposits also.

Exchange Banks compete with other banks in the country in borrowing money by means of deposits if not also directly in the lending and discounting business. Their operations are not thus restricted merely to the financing of import and export trade. They had, in 1927, 88 branches in India as compared with 165 branches (and three head-offices) of the Imperial Bank of India and 122 head offices and 406 branches of the Joint Stock Banks. The Indian deposits of these banks which are of primary importance from the point of view of India's trade, amounted in 1913, to £23·3 millions and rose to £56·3 millions in 1921, being £51·6 millions in 1927 as against Rs. 72 crores of private deposits of the Imperial Bank and Rs. 64·30 crores of the Indian Joint Stock Banks in 1927. As we have shown in the last Chapter, owing to the severe strain put upon the monetary resources of India by the War, the drawings of the Secretary of State had to be curtailed, gold could not be imported and exchange rose much above the standard rate. Exchange Banks had not adequate funds to buy bills and had, for some time, to sell drafts at a fixed rate; and they were compensated for this by government so far as their over-bought position resulted from the restriction imposed by the latter. The government's purchases of sterling drafts from the banks here saves the latter from the trouble to discount or realize the bills in London and then bring back the funds to India.

236. Joint Stock Banks :—Banks of the third class viz., the Joint Stock Banks, are almost all of them, of recent origin. The growth of this type of Bank has taken place during the last twenty five years, though some of the joint stock banks were founded more than a generation or two ago, and as may be expected, were the fruit of European enterprise. The total number of banking and loan companies registered under the Companies Act was 430 with a paid-up capital of Rs. 3·82 crores in 1900-01; the corresponding figures for

1905–06 were 595 and 4·40 crores; by 1910–11 the figures showed an increase in the amount of capital to Rs. 7·91 crores for 492 companies. Progress practically stopped after this on account of the failure of many Swadeshi banks; and then came the War. In 1919–20, the number of registered banking and loan companies was 556 and their paid-up capital amounted to Rs. 9,35,05,791. The post-war years witnessed a spurt in banking, and in a single year the capital was doubled, being Rs. 20·41 crores for 735 companies in 1920–21, and next year, the figures were Rs. 27·24 crores and 828 companies. The boom was succeeded by a depression and the numbers showed an appreciable falling off. Under the heading, banking and loan companies, are included hundreds of petty banking and lending establishments; and institutions carrying on operations on a considerable scale, are very few. It is not possible to obtain information about unincorporated and unregistered banking institutions scattered in large numbers all over the country. The number and the amount of paid-up capital of the registered joint stock banking companies are given below and they are analysed to show their composition.[1]

I

Joint Stock Banking and Loan Companies

Year.	Number.	Paid up capital (Crores of Rupees.)
1900–01	430	3·82
1905–06	595	4·40
1910–11	492	7·91
1913–14	552	7·91
1919–20	556	9·35
1920–21	735	20·41
1921–22	828	27·24

1 "The total paid up capital invested in banking, loan, investment and trust, nidhis and chit associations and insurance companies amounted in 1927 to about Rs. 25 crores of which 37 per cent. was in companies registered in the Bombay Presidency, 13 per cent. in the Madras Presidency 6 per cent. in Gwalior State."—Report on Joint Stock Companies for 1926–27.

II

Banking and Loan Companies.

	(1921–22) Number	Paid up Capital (Crores of Rs.)	(1926–27) Number	Paid up Capital (Crores of Rs.)
(1) Banking	386	13·17	518	10·25
(2) Loan	153	2·26	317	2·82
(3) Investment and Trust	52	9·42	69	7·00
(4) Nidhis and Chit Associations	237	2·37	279	2·60
Total	828	27·24	1183	22·77

The joint stock banks are classified, for the sake of convenience, into two main groups according to the amount of their capital and reserves; and their position on 31st December, 1927, was as follows :—

Joint Stock Banks

	No. of Banks.	Capital and Reserves	Deposits	Cash balances
		In lakhs of Rs.	lakhs of Rs.	lakhs of Rs.
(1) Banks with Capital and Raserve amounting to 5 lakhs and more. ...	29	11,08	60,84	7,70
(2) Banks with Capital and Reserve between Rs. 1 lakh and less than Rs. 5 lakhs. ...	48	1,22	3,46	52
Total of Banks with capital and Reserve of Rs. 1 lakh and above. ...	77	12,30	64,30	8,22

Joint stock banking is a plant of recent growth and has yet to drive its roots wide and deep into the soil though the European banks are of several years' standing. Nor are all the joint stock banks Indian-managed. While the sapling of indigenous joint stock banking was growing up vigorously, it was overtaken by a violent storm in 1913, when a number of banks collapsed. The failure of the banks caused ruin and hardship to numerous middle class and poor families, but it imparted a wholesome and much needed lesson

as it exposed the rotten condition of many of the apparently prosperous concerns. It indeed dealt a rude shock to public confidence, and for a time the progress of banking was retarded. But the exposure was calculated to teach the people where the screw of banking management was loose and to ensure a slow but healthy progress of the movement.

These facts are reflected in the following statements :—

I

Joint Stock Banks with Capital and Reserve of Rs. 5 lakhs and over.

(In crores of Rs.)

Year.	Number of Reporting Banks	Paid up Capital	Reserve and Rest	Total	Deposits.	Cash Balances.
1900	9	·82	·45	1·27	8·07	1·19
1905	9	·84	·77	1·62	11·98	1·73
1910	16	2·75	1·00	3·76	25·65	2·80
1913	18	2·31	1·32	3·64	22·59	4·00
1915	20	2·81	1·56	4.38	17·87	3·89
1920	25	8·37	2·56	10·92	71·14	16·31
1923	26	6·89	2·84	9·73	44·43	7·37
1924	29	5·13	3·80	10·71	52·50	11·27
1927	29	6·88	4·19	11·08	60·84	7·69

II

Banks with Capital and Reserve between 1 lakh and 5 lakhs.

Year.	Number of Reporting Banks	Paid up Capital	Reserve and Rest	Total	Deposits.	Cash Balances.
1913	23	·39	·11	·50	1·51	·24
1915	25	·45	.9	·55	·91	·20
1917	25	·44	·10	·54	·99	·20
1919	29	·58	·21	·74	2·28	·53
1921	38	·77	·23	1·00	3·26	·43
1923	43	·81	·30	1·11	3·26	·61
1924	40	·72	·34	1·06	2·66	·34
1927	48	·84	·37	1·22	3·45	·52

These joint stock banks came up on the crest of the Swadeshi or the enthusiastic industrial movement which began in 1905; and banking came to be regarded as a new path into which the energies of enterprising persons might strike. They undertook to do, on a smaller scale, almost the same work as the Presidency Banks, except the latter's treasury and other operations for government, and some of them dealt in foreign exchange also. The public was willing to patronise the new institutions and put their money in them. The middle class, which was in the habit of saving and of depositing its savings in the Postal Savings Banks, was attracted by the tempting prospect of getting a higher rate of interest and dividend, and the new concerns had no difficulty in attracting share-holders and depositors. From 5 to 6 per cent. interest (a high rate in those days) was offered for deposits fixed for a year or two years, and the banks helped many a shop-keeper and trader in his business by giving him accommodation.

237. Bank Failures:—Several causes combined to make the position of the joint stock banks insecure. (1) The directors of many of the concerns were men who knew little about practical banking business and could not and did not control the operations of the banks. (2) If some of those whose duty it was to keep a strict watch over the dealings of the banks, suffered from a lack of experience, others had too much of it to deserve the public responsibility entrusted to them. (3) Accounts were not properly kept and loans were given without sufficient security. (4) A large part of the funds of the banks was locked up in shares of industrial concerns and generally in such a way that it could not be easily realised. (5) Some of the managers went in for speculation, a species of business which such banks should have strictly avoided, and the monies taken from depositors at a high rate of interest, were used to finance concerns and schemes whose profitableness was doubtful. (6) Banking was combined in some instances with industrial and trading ventures of various sorts. (7) Dividends were often distributed among share-holders out of capital, and this fact could be concealed by window dressing, that is, skilful manipulation of the accounts. When, therefore, one of the banks came into trouble owing to the difficulty of meeting obligations and to a run being made upon it by depositors, public confidence was shaken and other banks also came down. Their assets could not be easily realised, the

demand of depositors could not be met and they had to close their doors.

These facts have been brought out in liquidation and other proceedings in connection with the banks, which have taken place in law courts. With a few exceptions most of the banks which have failed or have been liquidated, have been pigmy concerns. The following table shows their number and position :—

	No of Banks liquidated	Capital		
		Authorised	Subscribed	Paid up
		Rs. (1000)	Rs. (1,000)	Rs. (1,000)
1913 (two months) ...	12	2,74,00	1,64,56	3,53
1914 ...	42	7,09,70	2,45,47	1,09,01
1915 ...	11	56,50	7,79	4,50
1916 ...	13	2,30,90	20,90	4,23
1917 ...	9	76,50	35,75	25,26
1918 ...	7	2,09,50	4,86	1,47
1923 ...	20	21,86,89	9,92,36	4,65,47
1924 ...	18	6,30,30	26,46	11,33
1926 ...	14	70,80	7,05	3,98

The number of banks that failed or were wound up in 1919 and 1920, was 4 and 3 respectively and the amount of their paid up capital was 4 and 7¼ lakhs. But the number of failures increased to 7 and 15 in the succeeding two years, the paid up capital involved being 1¼ and 3¼ crores respectively. Many of these banks had high-sounding names but were ricketty from the very beginning. The paid-up capital bore a small ratio to the subscribed and the authorised capital and they were not able to do much business. This does not hold good of some other banks which have recently failed. The depression which succeeded the after-war industrial boom was responsible for as many as 20 failures in 1923, involving a paid-up capital of Rs. 4·65 crores. Of this amount, the Tata Industrial Bank, which was amalgamated with the Central Bank of India, the Alliance Bank of Simla and the Calcutta Industrial Bank contributed no less than Rs. 3·93 crores. The above facts are brought out in

the following table compiled from the information published by the Department of Statistics :—

Name.	Authorised Capital.	Subscribed Capital	Paid up Capital.	Deposits
	Rs.	Rs.	Rs.	Rs.
Solar Bank, Lahore; Registered, 17th April, 1913: Liquidated, 24th, March, 1914. ...	1,00,00,000	1,55,000	8,510	......
Orient Bank of India, Lahore, Registered, 18th May, 1907; Liquidated, 4th September, 1914.	25,00,000	10,00,000	71,354	4,94,958
Bank of Asia, Lahore; Registered, 2nd September, 1912: Liquidated, 29th November, 1914. ...	25,00,000	4,65,450	32,099	76,781
Commercial Bank of India, Gazipur, U. P., Registered, 17th January, 1913: Liquidated, 2nd July, 1914. ...	10,00,000	5,775	4,250	18,655
Sri Krishna Bank, Madras; Registered, 28th May, 1909: Liquidated, 31st March, 1914. ...	5,00,000	50,00,000	2,125	......
United Bank of Commerce, Bengal, Registered, 25th September, 1912; Date of going into liquidation, 14th August, 1918. ...	2,00,00,000	2,81,510	27,080	......
Tata Industrial Bank ...	12,00,00,000	7,50,52,200	2,25,15,660	......
Alliance Bank of Simla ...	3,00,00,000	88,94,100	88,94,100	......
Calcutta Industrial Bank ...	2,00,00,000	79,53,980	79,52,880	......

Banking corporations and bankers have to keep sufficient cash and liquid assets in their hands so as to be able to meet depositors' demands as they arise. But the Swadeshi joint stock banks did not follow this wholesome practice. While the proportion per cent. of the cash to the liabilities on deposits of the Presidency Banks was 33 and of Exchange Banks 20, on an average, that of the joint stock banks did not exceed 15 or 16. The position has steadily improved during the past few years, but the Imperial Bank of India and the Exchange Banks have now a smaller percentage. This is probably due to continued monetary stringency, dullness of business, growing banking habits among the people and the lock up funds in securities. The following table shows the proportion per cent. of cash to

liabilities on deposits of the several classes of banks on 31st December of each year. The figures for the Exchange Banks refer only to their Indian deposits :—

	1913	1916	1919	1922	1923	1927
	p. c.	p. c.	p. c.	p. c.	p. c.	p. c.
I Presidency Banks (Imperial Bank of India) ...	36	35	31	21	18	14
II Exchange Banks—						
(1) Banks doing a considerable portion of their business in India ..	19	25	35	19	19	11
(2) Banks which are merely agencies of large banking corporations doing business in Asia..	17	35	67	33	27	14
III Indian Joint Stock Banks—						
(a) Banks having capital and reserve of 5 lakhs and over ...	18	24	21	20	17	13
(b) Banks having capital and reserve between one lakh and less than 5 lakhs. ...	16	17	24	17	19	15

The lesson of the bank failures seems to have been taken to heart, and the joint stock banks now evince a desire to maintain a strong cash position ; and this tendency was especially marked in the abnormal conditions created by the war. Although banks have to provide for an adequate holding of cash against their deposit liabilities, it will vary from one class of banks to another and will depend upon the nature of its business and its requirements of safety. What is a safe margin for one type of bank, may be quite an insufficient proportion in the case of another. What is to be avoided by an ordinary deposit and commercial bank is the locking up of a large portion of its funds in assets not easily realisable—and speculation.[1]

1 The remarks made by certain shrewd observers in connection with the position of these banks before the failures of 1913-16 have proved almost prophetic. Mr. Keynes wrote—

"In the case of the smaller Banks, dealing, as they are, with clients to whom banking is a new thing, and in a country where hoarding is still dominant, the cash balances seem, from available indications, to be hopelessly inadequate ; and it is hard to doubt that in the next bad times, they will go down like nine pins. If such a catastrophe occurs, the damage inflicted on India will be far greater than the direct loss falling on the depositors."—Indian Currency and Finance.

238. Proposed Restrictions:—The failure of so many banks led the public and government to consider whether it would not be desirable to impose certain restrictions upon firms and individuals who used the words 'banks', 'bankers', or their equivalents, thereby gaining an amount of undue prestige in the eyes of people and attracting too large a quantity of deposits. The Government of India, therefore, issued a circular in August 1913, asking Provincial Governments to communicate to them the views of the commercial community and others on this point. They suggested that restrictions would be desirable in the following matters:—(1) The prescription of a minimum amount of subscribed capital; (2) a stipulation that an adequate portion of such capital should be duly paid up within a reasonable period from the starting of the business; (3) a restriction on the full allocation of profits to dividends pending the building up of an adequate reserve; (4) a restriction as to taking up by a 'bank' of business outside that of banking in which the banking profits might be lost. Some restrictions of the nature proposed by government are clearly necessary in the interest of the public as well as of a healthy growth of Indian joint stock banking. But any banking law that may be passed, should be such as will not hamper the growth of legitimate and sound business and as will only protect healthy development from the competition of unscrupulous and unsound concerns. Wide publicity, a thoroughly independent audit, a developed sense of responsibility and a vigilant and critical public, will alone be proper and effective checks on unsound banking.

The economic development of India requires an extension of banking facilities in all parts of the country. The people have to be taught the benefits of thrift and the advantages, individual and national, of acquiring the habit of handing over their savings to banks which will pay interest to depositors and at the same time, which will use the funds thus collected, for the promotion of trade and industry. There is a great scope for the expansion of banking; and concerns, small and large, if they are conducted along right lines, will be successful and helpful. High rates of interest rule in the market, and small business men and producers can not get the necessary accommodation without paying a heavy price. The ordinary money-lenders in towns and villages give credit to their clients, but charge exorbitant rates for their services. If banks were to collect cash from persons of small means and inspire confidence in the public mind, they would

assist in the economic development of the country. The right policy for the State to pursue in matters like this is to aim at the mean of the two extremes of too much interference with freedom of action that will discourage enterprise and progress and a *laissez faire* policy which is calculated to prove detrimental to public interests owing to the scope it allows to unscrupulousness and fraud. Some regulation of insurance and provident companies was found to be necessary on this principle and safeguards have now been provided in that behalf.

There are two points worth special mention in this place. Efficient management does not invariably save a bank from the consequences of a general public panic in a time of economic or political crisis. The inability of one bank to meet the claims of its creditors spreads a feeling of distrust regarding the soundness of the position of other banks. Should not something be done by public authority to prevent the spread of the panic and to assist well-managed banks to tide over the period of the scare? It was asserted that the failure of at least some Swadeshi banks could have and ought to have been prevented, but no one went to their rescue and all suffered alike. This question arose prominently in connection with the failure of the Alliance Bank of Simla in April, 1923. It was a big and well-established banking institution, and its current and savings bank balances amounted to Rs. 15½ crores in June, 1922. When it came into serious difficulties, its deposits were gradually withdrawn and its business declined. It was feared that the failure of such a reputed bank would deal a severe shock to credit; and in order to prevent it and 'to alleviate hardships to depositors in the Bank, the Imperial Bank of India, acting under the instructions of government, undertook to pay immediately 50 per. cent. of the amounts at credit of depositors including current account and savings bank balances, provided the liquidation of the Bank was carried out under surveillance of the Imperial Bank.'[1] Here the question arose whether this measure of State assistance was special and similar consideration would not be shown to banks under purely Indian management or represented the deliberate policy of government under which other banks might expect help under like circumstances. The case of the Alliance Bank was generally regarded

1 Report of the Controller of Currency, 1923-24.

as a welcome precedent; but past experience hardly warranted the belief that government would look upon it as such.

Wild rumours about the solvency of a bank very often bring about a run upon it and on other banks, and the proposal has, therefore, been made that legislative measures should be taken for the protection of banking institutions and the investing public against wanton scare-mongers. As the interests of the community require to be safeguarded from the mismanagement and fraud on the part of banks, so the latter deserve to receive a guarantee that their reputation and existence will not be at the mercy of irresponsible mischief-makers. This proposition will win general assent, but there are practical difficulties in the way relating to the rights of share-holders and the depositors and the freedom of public comment. It is mainly for this reason that the above suggestion has not been given effect to.

239. Land and Agricultural Banks:—There are no land banks and agricultural banks worth the name in India like those in other countries,[1] though Zamindari and land mortgage banks have been recently started in some Provinces. Landholders have, therefore, to raise loans by mortgaging their lands to money-lenders, and ordinary cultivators obtain advances from the village sowkars for the current expenses of agriculture. *Takavi* loans are made by government to cultivators, but they are not popular, and they do not satisfy the smallest fraction of the needs of the people. The indebtedness of the Indian rayats is colossal, and attempts made to relieve it, like those of the Loans Acts of 1883 and 1884, have almost failed. There are here two problems to be tackled, first, to enable the farmer to shake off the burden of the old debts; and second, to advance to him the capital required to carry on his agricultural operations. If there were banks which would supply this two-fold credit, the cultivator's lot would be vastly improved. But he has as yet to rely, where there are no co-operative credit societies—and these are too few in view of the large population of the country—on the old credit machinery viz. the money-lender who charges high rates for his money. The bigger landlords who want capital for the permanent improvement of their farms or for their current needs of farming, and have to face

1 See Gide's Political Economy and the next Chapter of this book.

the same difficulty, present the third problem. They can obtain loans on the security of their real estate, but there are no special land banks which will lend them large amounts of money at reasonable rates of interest. It is not a little disappointing to find that the idea has not been taken up by our Jamindars, Jahagirdars and Inamdars. The position of the Gujarat Taluqdars and of the estates under the management of the Courts of Wards, points to valuable lessons which may be taken to heart with advantage in this respect. The distinction between the current needs of agriculture and land improvement and between credit required by a landlord and a peasant proprietor on the one hand and by the tenant on the other, is important and has to be carefully borne in mind.

We have shown in Chapter VI what is the position of the cultivator and the common artisan with regard to credit and supply of capital. In one of his pamphlets on Agricultural Banks in India, Mr. (now Sir) D. E. Wacha pleads for the establishment of land banks which will emancipate the cultivators. He gives an account of the experiment of such a bank in Poona district which was to have been made about the year 1883, and argues that after all, co-operative credit societies are not calculated to solve the problem of agrarian indebtedness.[1] He holds up the Agricultural Bank of Egypt to imitation in this country and wishes enterprising men to start such banks and conduct them with the assistance of government. There can be no doubt about the fact that the problem of agricultural indebtedness ought to have been boldly faced by the State long ago; and the cultivator should have been assisted to throw off the yoke of his debt, by means of agricultural banks. In Ireland and in France, for example, the State has been placing large funds at the disposal of cultivators. England and U. S. A. have made arrangements for supplying farmers' capital and similar proposals have been considered recently by Provincial Banking Committees in India. This is not to minimise the urgent importance of the growth of the co-operative cridit societies which are calculated to improve the status and economic position of the rayat as nothing else can, but to point out the colossal dimensions of the rayats' indebtedness and to suggest the radical and effective cure necessary to wipe it out. Land mortgage banks on the lines of those in Germany, will serve a useful purpose in India, bringing as they will, owners of

1 See Chapter VI as also the next Chapter.

land and of surplus capital together. What is required is enterprise, organization and State help. The position and the needs of land-holders of different status are not the same and consequently they can not be met with any uniform system of credit and banking. The latter must be adjusted to the requirements of localities and of classes of landlords and of tenants. Land mortgage banks have been in existence in the Punjab and are now being established in the Madras Presidency and in Bombay; and the other Provinces' proposals with reference to them are being discussed. We shall revert to this subject in discussing credit co-operation.

240. Industrial Banks:—The want of industrial banks is being similarly keenly felt. The Imperial and joint stock banks lend their monies for short periods, and they can not afford to lock up their funds in ordinary securities or in new industrial concerns. Like agriculture, industries require a special treatment, and it has been suggested that banks should be started for financing industrial enterprise. State assistance is also invoked in the matter though how precisely it should be rendered is a difficult point to settle. Government may advance capital on the security of the property of a concern when the loan has been recommended by competent authority; or it may guarantee a certain rate of interest as it did in the case of railway enterprise. Various provincial governments, notably those of Madras, Bihar and Orissa and the United Provinces, have thus advanced capital to industries during the last few years; and the latest example of this form of assistance is that of paper manufacture in Madras. Financing of industries would certainly be better done by private banks strongly supported and supervised by the State. And if branches of such central banks were opened in small towns, the producers there would derive material benefit from them, and the banks themselves would do good business. But the nature of the work expected of industrial banks is fundamentally different from that of ordinary commercial banks. Their funds must be locked up in land, buildings and plant for long periods and their deposits must consequently not be subject to withdrawal at short notice. The purposes for which loans are made have likewise to be scrutinized with greater care, and more vigilance has to be practised over their use. Here too the special requirements and conditions of large-scale industries, of factories of middling size and of handicrafts must be carefully distinguished and dealt with.

Organising capacity, natural advantages, reasonable prospects of success and efficient management are the essential requisites of industrial development. No new industries can be started unless they have the backing of men with capital to finance them or of industrial banks which will make it their principal business to support sound propositions. Such industrial banks do not exist in this country and their work can not be done by the ordinary deposit banks. Neither the Imperial Bank nor the joint stock banks nor individual bankers can assume this role, as they can not lock up their funds in industrial concerns for long periods and do not possess the expert agency necessary to scrutinise the industrial proposals placed before them. It is just possible for the Imperial Bank to make special provision for industrial and agricultural finance, and suitable schemes will have to be worked out. But the fundamental difference between commercial and industrial banking is too important to be ignored or minimised. Japan has already equipped herself with industrial banks, and all other nations have been awakened to the urgent need of such institutions. Messers. Tata, Sons and Company took the lead in starting an Industrial Bank with a large capital and its progress was watched with the keenest interest. The difficulties it had to encounter in its initial stages and the limits it found necessary to impose upon the nature and the extent of its operations, illustrate, in an instructive manner, the characteristic features of this species of banking. Economic conditions in India and outside, unfortunately proved unfavourable to the progress and the ultimate success of the adventure. Small industries too suffer from the lack of initial capital and short-time credit for current expenses. Rich people provide their own capital but others have to pay high rates of interest and can not obtain credit from joint stock banks and indigenous bankers. Cotton gins and presses, oil mills, flour mills and tile factories are industries of this type.

241. Their Possibilities :—The Indian Industrial Commission felt called upon to devote its attention to the constitution and functions of industrial banks that were required in this country and considered how far they ought to receive assistance from government. It examined the position of industrial banks in Germany and Japan to find out if they could provide a lesson and a precedent for India. With regard to the German industrial banks three characteristics were found to be striking: (1) the high proportion of their paid-up

capital to their total cash transactions; (2) the readiness with which they financed industrial and commercial business and participated in fresh industrial ventures, by taking up and eventually selling blocks of shares in such undertakings; and (3) the large measure of control they exercised over the businesses financed by them through the appointment of their representatives as directors. It is believed that the banks have had the backing of the German government which is anxious to stimulate industrial enterprise through them. The government of Japan likewise supports the industrial banks in that country and imposes on them certain conditions as to the investment of their capital with a view to ensure their sound and successful working. On this evidence before it, concerning the part played by banks specializing in industrial finance and the support accorded to them by the State in Germany and Japan, the Industrial Commission could not but conclude that the industries in India would materially benefit by a similar system established in this country. The Tata Industrial Bank was started with the object of financing indigenous industries on the lines suggested above; but many such banks are needed for providing adequate finance to new ventures. The business of industrial banks is, of course, full of risks and special precautions have to be taken by them in laying out their funds. The Industrial Commission has indicated these safe-guards and they relate mainly to the judicious use of their capital by the banks.[1]

The six points emphasised by the Commission in this regard are, (1) that an industrial bank should possess a paid-up share or debenture capital high in proportion to its total business; (2) that too large a share of its funds should not be used for the benefit of any single interest or a group of interdependent interests; (3) that its loans on plant, land and buildings should be carefully limited; (4) that a large portion of its funds should be confined to provision of working capital; (5) it should provide initial capital with caution and should not itself at first attempt to float new companies, and (6) that each class of its business should be judiciously limited to its proper proportion. The Tata Bank started work in April, 1918 in Bombay without government assistance; and though government must help industries directly in a variety of ways, it is best that industrial banks should multiply so as to be able to stimulate the development

1 Report, para 291.

of industries through private agency. The paid-up capital of the Bank was 70 lakhs at the start and was raised to about $2\frac{1}{4}$ crores within a few years. The Bank opened branches at Calcutta, Hyderabad (Deccan), Cawnpore, Delhi, Lucknow, Madras and in London in course of time and combined the business of ordinary commercial banking such as dealings in exchange, discount and over-drafts with the finance of industries. Such combination was perhaps necessary to ensure the profitableness of its working in the initial stages. But the decision of its Directors announced in 1922 to suspend the industrial side of its operations reduced the concern, on which such high hopes of India's industrial development were built, to the position of an ordinary commercial joint stock bank, to the serious disappointment of the public. The experience of the Directors of three years' working was not probably such as to inspire confidence about prospect of success in the industrial ventures financed or proposed to be financed by the Bank. It was, in any case, a national misfortune that India's first industrial bank had to suspend the industrial side of the work and had ultimately to be amalgamated with the Central Bank of India. The Industrial Commission had expressed the opinion that "the establishment of industrial banks working on approved lines is of sufficient national importance to justify Government assistance," but having no sufficient material before it to allow it to formulate a definite scheme for industrial banks, whether of provincial or imperial scope, it suggested the appointment of an expert committee to examine the whole question of additional banking facilities and the form which government assistance and control should take. The Central and Provincial Banking Committes appointed in 1929, are expected to investigate this question also, but it is doubtful if they will make any concrete recommendations that will be immediately followed up.

242. The Bank Rate:—The bank rate is the rate which is charged for loans against government securities, while the rate of advances on other securities and of discounts is slightly higher. The rates are not the same in the different Provinces. As we have said above, this business is, at present, done by shroffs and other money-lenders who deal in hundies. They grant accommodation for a few months and charge varying rates of interest. The shroffs in big commercial centres are a link between petty traders and shopkeepers and the Imperial and joint stock banks, the latter discounting their

bills and thus coming indirectly in contact with the small businessmen. The bank rate naturally depends upon the stringency or easiness of money and on the intensity of business activity in the country; and it regulates the rates for accommodation on different securities.

The official bank or discount rate of the Imperial and other banks is, however, not identical with the rate that prevails in the bazars, and the latter is often not much affected when the bank rate rises owing to monetary stringency which occurs periodically. "The shroffs who finance nearly the whole of the internal trade of India, rarely, if ever, discount European paper and never purchase foreign or sterling bills. Neither do they lend money on Government Paper or similar securities, but confine their advances to the discount of *hundees,* to loans to cultivators and against gold and silver buillion. The *hundees* they purchase are, for the most part, those of traders, small and large, at rates of discount ranging from 9 to 25 per cent. per annum; but the *hundees* they buy from and sell to each other, which are chiefly the traders' *hundees* bearing the shroffs' own endorsement, rule the rates in the native bazar and are generally negotiated, during the busy season, at from 5 to 8 per cent. discount. They also discount their endorsements pretty largely with the Presidency Banks when rates are low and discontinue doing so when they rise above 6 per cent. They also speculate largely at times in Government Paper, especially during the off season, but rarely or ever hold it or lend on it."[1]

The bank rates are usually regulated by the intensity of demand for money required for financing the export of Indian staples to foreign countries and the supply of raw materials to large indigenous industries. The comparatively high bank rate in India has been a subject of serious complaint for years, and government's policy regarding the expansion and contraction of currency with which it is intimately bound up, has been already commented on. Government and the Imperial Bank, between them, thus control the Bank rate. The urgent importance of having a Central Reserve Bank which will combine the national reserves of capital, is thus realized. The money supplied by the shroffs usually goes to finance the local movement of the staple crops from the fields to the markets. Funds

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1 Appendices to the Report of the Fowler Committee, page 70.

may be taken from the banks to return the advances made to dealers by shroffs and in that way the two money markets come into contact with each other. But, as a matter of fact, the indigenous shroffs draw very little on the joint stock banks for the finance of trade and more or less rely upon their own resources. When money is tight, the Presidency Banks attracted deposits for short periods by offering higher rates of interest and put up their lending rate at the same time. The rates are naturally high in the busy season and low when trade is slack. Thus the half-year ending 30th June witnesses higher rates than the other six months when there are no crops to be moved. The rates are readings of the financial barometer which is extremely sensitive to the changes in the commercial weather. The following table gives the maximum and minimum rates for a series of years:—

Bank Rates.

I—PRESIDENCY BANKS.

	1913 (Pre war year)		1918–19		1919–20		1920–21	
	Maximum	Minimum	Maximum	Minimum	Maximum	Minimum	Maximum	Minimum
	p. c.	p. c.	p. c.	p. c.	p. c.	p. c.	p. c.	p. c.
Bank of Bengal ...	8	3	7	5	7	5	7	5
Bank of Bombay ...	7	3	7	5	7	5	9	5
Bank of Madras ...	7	5	8	6	8	6	9	6

II—IMPERIAL BANK OF INDIA.

	Half year ending 30th June	Half year ending 31st December	Annual Average.
1921	6·04	5·11	5·57
1922	7·13	4·51	5·81
1923	7·42	4·50	5·96
1924	8·05	5·32	6·68
1927	7·00	5·3	6·2

243. The Hundi Rate:—The relation between the Bank Rate and the Hundi Rate has been a subject of some curiosity.[1] The nature of the dealings of the shroffs who discount hundies with the Banks has been shown above. The big shroffs go to the banks when they have laid out all their funds in purchasing the hundies of smaller shroffs who may have financed the village bania or dealer. There are two chief kinds of hundies, the 'hand bills' or pure finance bills, and the trade bills. As regards the hundi rate, it "rises and falls with the bank rate proper, though somewhat in advance of it, and naturally so, for one is a discount rate and the other a rate for day-to-day loans. Thus at the beginning of the busy season, the hundi rate would usually be higher than the bank rate; the reverse being the case when the slack season is about to begin, so that the hundi rate may be said to be a sort of long distance signal."[2] As indigenous bankers mostly carry on business with their own funds, they have a fixed lending rate among themselves and only a few shroffs e. g. Multani or Shikarpuri, that borrow or get bills rediscounted from the Imperial or any other bank. From the report of the Controller of Currency for 1920–21, it is seen that during the year, the average rate at which shroffs were prepared to discount petty traders' bills, was 1 to 2 per cent. higher than the Bank rate in the Calcutta bazar.

It should be noted that hundi rates are governed, more or less, by special local conditions and customs, and the variation between them and the bank rate can be accounted for only on that ground. In 1922–23, for example, shroffs in Bombay who had suffered heavy losses in their business in the preceding year, charged much higher rates for discounting traders' bills than those of the Imperial Bank of India but normally, the Calcutta bazar bill rate is one or two per

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1 The *bank rate* is the rate at which the Imperial Bank will ordinarily advance money against government securities, while the Imperial Bank *hundi rate* is the rate at which the Imperial Bank will discount or rediscount first class three months' bills. The *bazar rates* are those at which the bills of small traders are discounted by shroffs."—Report of the Controller of Currency for 1928–29.

2 Appendices to the Report of the Indian Currency Committee, 1919.

cent. higher than the corresponding Bombay rate. The following statement shows the special conditions in the above year.

1922–23

	Bank Hundi rate	Bazar rate	
		Calcutta	Bombay
	Per cent	Per cent	Per cent
April	8½	9 to 10	13
May	7½	9 to 10	12¼
June	7	9 to 10	12
July and August	5	6 to 7	9¾
September & Oct.	5	7 to 8	9¾
November	5	7 to 8	9
December	6	7½ to 8½	10½
January	8	7½ to 8½	12
February	9½	10 to 11	13½
March	9½	8 to 9	13

A divergence of the nature reflected in the above table between the Bank and the Bazar rate, prevailed also in 1923–24. The Hundi business of the Presidency Banks often represented as much as one-third of their total advances. The following table shows these proportions as an illustration in the case of the Bank of Bombay :—

Bank of Bombay (In lakhs of Rupees).

Date		Bills Discounted	Advances	Total
1909	30th June ...	163·37	559·46	723·43
	31st December ...	266·54	513·93	780·47
1913	30th June ...	216·29	580·84	797·13
	31st December ...	154·22	551·20	710·49
1916	30th June ...	98·26	613·75	711·01
	31st December ...	113·05	599·77	722·86
1918	30th June ...	82·23	887·46	976·28
	31st December ...	29·69	1193·09	1222·78

244 Reserve Treasury System:—While on this question of the bank rate in India, we may refer to the prolonged controversy which raged round the reserve treasury system of Government and the artificial stringency which was alleged to be created by it though in view of the establishment of the Imperial Bank and the transfer to it, of funds formerly kept in the reserve treasuries, it has now only an academic interest. Apart from the Paper Currency and Gold Standard Reserves which have nothing to do with the current revenue and out-goings of government, the funds of the State are held in the treasuries and sub-treasuries[1] scattered over the country, at the head offices and branches of the Imperial Bank, (formerly in the Presidency Banks, and also in the Reserve Treasuries) and in the 'Home Treasury' which keeps its balances with the Bank of England. By experience it has been found that the official year should open normally with a balance of Rs. 18 crores in India and £ 5 million in England. Under agreements with the Presidency Banks, government was bound to keep certain amounts of its balances free of interest at their head offices, and in practice, it left with them larger balances than those fixed amounts. What amount each treasury should hold had been fixed in the light of experience and the surplus balances were kept in the three 'Reserve Treasuries' in Calcutta, Bombay and Madras, to be drawn upon when required. The following table shows how the Indian balances have been distributed :—

(*Lakhs of Rs.*)

Last day in March	Treasuries	Head offices of Presidency Banks	Branches of Presidency Banks	Reserve Treasuries	Total
1910–14 (Pre-war average) ...	9,42	2,08	2,81	7,60	21,91
1915	10,17	2,62	3,33	6,05	22,17
1917	8,26	5,95	4,17	4.56	22,94
1918	7,57	9,55	3,40	2,47	22,99
1919	7,25	11,81	3,33	3,58	25,97
Five war years' average ...	8,35	6,42	3,60	4,05	22,42
1920	11,26	13,66	3,64	1,55	...
1921	7,46	6.40	...	...	...

1 "In the United Provinces there are 49 treasuries, 40 in Burma, 30 in Bombay, 29 in Punjab, 27 in Bengal, 25 in Madras, 22 in the Central Provinces, 20 in Behar and Orissa, 13 in Assam, and 13 mainly in Indian States *i. e.* political. These 'political' treasuries do not have the usual fluctuations that are due to different seasons of revenue collections. Of the total number of treasuries 46 per cent. are medium, 31 per cent. small and 16 per cent. large."—G. Findlay Shirras: Indian Finance and Banking, page 311.

It was contended that by locking up crores of rupees in its treasuries, the government caused a scarcity of money in the busy season, and a regular system under which loans might be made to the Presidency Banks during the time of monetary stringency, had been suggested. Government has granted such assistance from time to time, but it was naturally reluctant to develop it into a regular system which it would be bound to follow. The creation of special Reserve Treasuries was forced upon government by the inability of the Bank of Bombay to meet its demand for money deposited with the Bank under an agreement of 1866, and for guarding against such dangerous contingencies in the future, government decided to keep with the Presidency Banks only certain fixed amounts and to hold the surplus in the Reserve Treasuries established at Calcutta in 1876 and at Bombay and Madras three years later.

This system which locked up and withheld from the market large sums of money, causing the bank rate to mount up, had been a long-standing grievance of the banks and financiers in India. And the public feeling of discontent was accentuated by the fact that during the five years 1908–13, government balances soared unusually high, and the Secretary of State having withdrawn[1] a large portion of them, lent them to approved borrowers or deposited them with banks in London. So far as the question of a high bank rate in India and the reserve treasury system of government is concerned, we do not think that having at their disposal crores of public deposits kept with them by government, the Presidency Banks could reasonably complain against the reserve treasury system which was intended to provide a financial safeguard, though we do not understand why Indian funds should have been transferred to and lent in England and should not have been placed at the disposal of trade in this country.

1 The balances for the years 1908–1913, were as follows :—

			In London Mill £.	In India Mill £.	Aggregate Mill £.
31st March,	1908	...	4·60	12·35	17·45
„	1909	...	7·98	10·23	18.21
„	1910	...	12·79	12·29	35·07
„	1911	...	16·69	13·56	30·26
„	1912	...	18·30	12·27	30·66
„	1913	...	8·78	19·29	28.07

245. Government's Policy:—In two notes which he wrote as far back as in 1881 and 1899, on this subject, Sir James Westland put up a strong defence in favour of the system. He pointed out that there was no analogy in that connection between the position in England and that in India. In England, the diminution of the balance in the Bank of England by the whole amount it holds at the credit of the Exchequer, would be a small tax upon the whole banking balance of the place; and secondly, "the nexus between the Bank of England and the general available cash of the country is infinitely closer than that which exists in the case of the Presidency Banks."[1]

Looking to the fact that banking was progressing rapidly in this country, the Presidency and the other banks should have stood on their own legs and not looked up to government for assistance every time. They could not rouse genuine public sympathy as they rendered limited help in the finance of internal trade and of indigenous industries. The fluctuations in the bank rate between the busy and the dull season are, no doubt, great in India, but government have to conserve their resources in view of demands likely to be made upon their balances, and cannot be expected to place them at the disposal of banks. It is true that on account of the prevalence of the reserve treasury system, the reserves of the country were placed in two water-tight compartments and could not be fully utilized to the serious inconvenience of trade. The real solution of the problem, however, lay in the establishment of a State Bank which would stand to the Government of India and the Indian business community in the same relation as the bank of England does to the British Government and British trade and industries. The Government of India held the following view which they laid down in a letter written to the Secretary of State in 1900, viz.—"regarding the general danger involved in the financing of trade by the Government we have before us the words of Lord Salisbury's Despatch of 6th May, 1875, that "capital supplied by Government, and not representing the savings of the community, is a resource on whose permanence no reliance can be placed, and which therefore tends to lead the trade into dangerous commitments." The warning conveyed in those words still holds good. The Presidency Banks have excellent reserves, it may readily be admitted. But

1 See Appendix II to Chamberlain Commission's Report.

those reserves could not, in the peculiar circumstances of India, be suddenly converted into cash, and it seems, therefore, undesirable that the account of one depositor, and that one, a Government exposed, as the Government of India is in a most unusual degree, to sudden calls and emergencies, should occupy a position of such dangerous importance."[1]

In taking a review of his financial stewardship, Sir William Meyer observed in the Viceregal Council that one of the problems he had wished to tackle, had reference to the periodical money stringency which is a characteristic of the busy trade months of the year in India. As the policy of government of locking up funds in its treasuries had been subjected to strong adverse criticism, the Secretary of State's assent was obtained to a modification thereof and it was decided to make loans to the Presidency Banks in times of stringency. Sir William had to face a difficult situation of financial strain caused by the war and he found it beneficial to deal liberally with the Presidency Banks by keeping with them larger balances, leaving on deposit, till actually required, the proceeds of public loans and avoiding the lock-up of funds in the reserve treasuries.[2]

The change of policy necessitated by the exigencies of the war, particularly the need to keep larger balances with the Presidency Banks for facilitating public investment in the loans floated by government, is reflected in the following table,[3] which shows the percentage share of the treasuries and the Banks in the balances:—

Percentage shares.

	No. on March 31,1919	Pre-war average 1910-14	War average 1915-19	March 31,1919
District treasuries ...	272	43	37	28
Presidency banks—				
Head offices ...	3	9	29	45
Branches ...	42	13	16	13
Reserve treasuries ...	3	35	18	14
Total ...	320	100	100	100

1 Appendix 1 to the Chamberlain Commission's Report.
2 Speech made in presenting the Financial Statement for 1918-19.
3 G. Findlay Shirras: Indian Finance and Banking, page 310.

But this did not solve the problem of periodical monetary stringency and of the lock-up of funds in reserve treasuries, because in view of emergencies government felt it desirable to maintain its own reserve and could not rely upon the Presidency and other banks. On the creation of the Imperial Bank of India in 1920, this position was radically altered. From the figures given above it will have been seen how the amount kept in the reserve treasuries was gradually reduced, and now the whole of the government balances are entrusted to the Imperial Bank with the exception of the treasury balances at places where there is no branch of the Imperial Bank. The average amount of balance at Government treasuries has recently been only Rs. 2½ crores while that at the Imperial Bank of India was Rs. 19·9 crores in 1926–27, Rs. 10·5 crores in 1927–28 and Rs. 8·0 crores in 1928–29. The state of the money market is considerably influenced by Government borrowings, particularly in the shape of treasury bills sold to the public and ways and means advances taken from the Imperial Bank of India. These borrowings depend on the fluctuating condition of treasury balances and the demands of public expenditure and have to be judiciously effected so as not to act prejudicially on the money rates in the market. The largest amount of outstanding ways and imeans advances in 1928–29 was Rs. 11 crores in December which were fully repaid by the end of the year, while the highest outstandings of treasury bills were Rs. 17·9 crores in June, reduced to Rs. 3·9 crores in March.

246. Savings Banks:—Taking the small savings of the public on deposit, subject to withdrawal on definite conditions, is a branch of the work of the ordinary bank. As interest has to be paid on the deposits and as sufficiently large balances must be kept to meet the demands of depositors, adjustment of cash to liabilities has to be made with particular care and caution. The banker places his eggs in different baskets and he has to handle these in appropriate ways while never lossing sight of the financial position of the bank as a whole. The small man wants security and a steady return for his money, above everything else and is content to receive a moderate rate of interest on his deposits provided he can draw upon them without difficulty. Deposits fixed for periods of one year or more give greater lattitude to banks and higher returns to depositors. Post Office Savings banks have always

provided people of the educated middle class with the convenience of a secure means of depositing their small savings, and they have been availed of by all those who did not care to speculate and run after higher rates of interest and dividend at the risk to the safety of their money. "In 1833 with the failure of the commercial houses of Calcutta, a Government Savings Bank was formed to afford to Europeans and Indians alike a means of investing their savings apart from the uncertain influences of commerce. Until 1882–83 the business of the Government Savings Bank was conducted by the Presidency Banks in Calcutta, Bombay and Madras and by Government treasuries elsewhere. The Post Office took over the management of them from that date and in the first year of the existence of a Savings Bank under the control of the Post Office, a great change was manifest and Government had actually to take measures to prevent a too rapid increase in deposits. In 1911, the deposits, inclusive of interest, amounted to 17 crores, of which 15½ crores belonged to Indians."[1]

That the handing over to the Post Office of the savings banks business was a great facility appreciated by the public, was manifested by the rapid increase in the deposits which took place after the transfer although government took steps to prevent the progress from being inconveniently brisk. In 1889–90, the maximum sum receivable was reduced from Rs. 3,000 to Rs. 2,000; and in 1894–95, the rate of interest was reduced from 3¾ per cent. to 3⅛ per cent. in correspondence with reduction in the rate on government securities. In 1893–94, the balance was Rs. 9 crores; in 1902–3, it was Rs. 11 crores; and in 1913–14, inclusive of interest, the amount was Rs. 23 crores. In April 1914, the maximum was raised to Rs. 5,000, but on the outbreak of the War there were heavy withdrawals. There was a gradual recovery after the close of the war though government did not raise the rate of interest to attract depositors.

The deposits in the Post Office Savings Banks form the unfunded debt of the Government of India and are used by it for capital expenditure. Government is a big banker and it borrows and lends

1 "Government Savings Banks were established in the Presidency towns between 1833 and 1835. That in Calcutta was founded in 1833 after the bank failures of 1832. In 1870 district savings banks were instituted in connection with selected district treasuries. The Post Office Savings Banks, opened in all parts of India in 1882 and 1883 absorbed the district savings banks' business in 1886 and that of the Presidency Savings Banks in 1896."—Findlay Shirras: Indian Finance and Banking, page 386.

money. Its general balances are the source from which depositors are paid when they want to withdraw their money, and on the outbreak of the War there were heavy withdrawals which were all met from the balances. In 1914, government offered certain additional facilities to depositors by raising the limit of the amount of their annual and total deposits as well as by helping their investment in government securities. These facilities drew large deposits from the public, their total amount reaching 23 crores of rupees in 1914. The public has been recently purchasing large quantities of government securities through the Post Office and many of these are held in the custody of the Accountant General, Post and Telegraphs, on behalf of depositors. The increasing popularity of the Post Office Cash Certificates whose holding increased from Rs. 3.1 crores in 1923 to Rs. 32.3 crores in 1929, demonstrates the growing investing habit of the middle class public and the stimulus imparted to it by additional facilities as regards encashment.

The following are some important figures in connection with Post Office Savings Banks :—

Year	No. of Depositors	Deposits (inclusive of interest)	Withdrawals	Balance of Deposits (inclusive of interest)
	No. (1,000)	Rs. (1,000)	Rs. (1,000)	Rs. (1,000)
1900–01	816	3,90,65	3,50,97	10,04,33
1905–06	1,116	5,50,06	4,91,50	19,99,26
1911–12	1,501	8,78,70	6,80,72	18,89,85
1913–14	1,639	11,60,37	9,04,76	23,16,75
1914–15	1,644	9,60,62	17,88,11	14,89,29
1915–16	1,660	8,16,32	7,73,46	15,32,12
1918–19	1,677	13,45,15	11,21,17	18,82,44
1920–21	1,877	18,84,85	17,33,48	22,86,21
1923–24	2,089	21,39,20	19,80,36	24,78,83
1925–26	2,317	19,78,64	18,19,48	27,23,14
1926–27	2,508	21,17,01	18,89,26	29,50,86
1928–29				34,74,00

The normal growth of the deposits in the Post Office Savings Banks was arrested by the set-back received by them on the outbreak of the War. The check was, however, only temporary, and if the amount of the deposits did not soon return to the pre-war level, the cause is to be sought in the withdrawals by people for investment in war loans and the more attractive rates of interest offered by other government securities. A difference of 3 per cent. in the two rates of interest, sufficiently explains the slow progress of the deposits. The failure of joint stock banks in 1913, diverted the flow of money from them to the Postal Banks as Swadeshi banks had formerly attracted the savings of the people of the middle class to themselves by their more attractive rates of interest. These tendencies will be found clearly reflected in the figures given in the table above.

The Presidency and the joint stock banks have had savings departments attached to them, and here there is an unlimited field which must be properly exploited. Small savings of the people must be collected to finance trade and industries and thus to promote the economic development of the country. Co-operative societies are now tapping this source, as we shall show in the next Chapter; and the general policy which government has followed since the outbreak of the War in the matter of finance, will go a long way in teaching the people the habit of saving and lending. The Central Bank of India, for instance, has been making special efforts to educate the middle class public to save and bank small amounts of money. A separate Post Office branch was tacked on to the public loans during war-time, and contributions were received through the Post Office. The first attempt yielded about half a crore; and the cash certificates offered along with the War Loans as also the opportunity given to contribute to other securities through the Post Office, were steps in the right direction.[1] The number of accounts in the Postal savings banks and

1 "We have further opened up new borrowing sources and I refer here specially to the postal section of the last three loans and to the cash certificates. The former method of utilising the Post Office to get into touch with the small investor was introduced for the first time in 1915-16 when it gave us £½ million; while in 1916-17 it yielded a little less. But this year the postal section of the War Loan produced nearly £3 million, a larger sum than we raised by ordinary methods in any year between 1907-08 and 1913-14; while the cash certificates will have given us in this first year of their issue about £6½ million (gross), a result exceeding those of any of our public loans before the present year."—Speech of Sir William Meyer in introducing the Financial Statement for 1918-19.

the amount of the balance of deposits are steadily creeping up, the pre-war position having been already reached and passed. Though the Imperial and ordinary banks are developing their savings bank business, the Post Office must make its own contribution to progress along those lines.

247. A State Bank:—The question of starting in India, a Central or a State Bank on the lines of the Bank of England, the Bank of France or the Reichsbank, had been under discussion for several years before the Presidency Banks were amalgamated into the Imperial Bank of India in January, 1921. In India, the note issue is still a monopoly of the State while in other countries it is a right conferred upon one central Bank, or upon a few banks on certain conditions. The government, therefore, has to perform here many functions which ordinarily fall within the province of a Bank. The State has its treasuries, (and until recently it had its reserve treasuries also) supplies the currency required for the movement of crops at different times and in different provinces, keeps its gold standard and currency reserves, meets Council bills and sells sterling drafts, borrows here and in England, and lends to approved borrowers in London and to municipal and local bodies and cultivators in India out of its surplus balances. The relation of all these banking operations and the ordinary transactions of the money market, must be very intimate, and it is now sought to be maintained through the agency of the Imperial Bank. But it is felt that in the interests of the trade and of the general public, it would be much better if government transferred all the above functions to a central Reserve Bank, the latter, of course, carrying on its business, more or less, under State supervision and control.

The idea of a central bank for India was mooted as early as in 1836, and the first Indian Finance Member wrote a minute on the subject in 1859. A scheme for the amalgamation of the three Presidency Banks into such a Central Bank was formulated in the year 1867, but nothing further was done and the question formed the subject of discussion again in 1899 and 1900. Both the Secretary of State and the Government of India were favourably disposed towards the idea, but it was temporarily abandoned as it was thought that the time was not propitious; and 'provincial and personal jealousies' were also a cause of the abandonment of the scheme. It was revived thirteen years later and came up for consideration before the Chamberlain Commission. But the latter declined to express

any definite views on it and to make any recommendations about it in the absence of sufficient material and an opportunity for adequate discussion. Mr. J. M. Keynes, one of its members, however, drew up an exhaustive Note dealing with the proposed Central Bank and attempted to show how such a Bank was not only desirable but also perfectly feasible. He gave an outline of the constitution and functions of an Indian State Bank and discussed arguments in favour of and against it.

Expert opinion on the question was divided. Some did not think that the one bank, however large it might be, would be able to satisfy the needs of such a continent as India, and they favoured the continuation of the three Presidency Banks. They felt that what was wanted was only a suitable adjustment of the existing machinery to the growing requirements of the country. They apprehended a danger in this 'placing all the eggs in one basket,' and were not sure that the position of government would be improved with a central bank rather than without one. What was wanted, they urged, was not a concentration of banking but more Indian banks conducted by Indians.[1] There was some force in this view, but the idea of a Central Bank was worth giving effect to provided the interests of the public were properly safe-guarded and the economic development of the country was promoted thereby. In fact, the need of a large central State bank was being more keenly felt every day. With the expansion of the paper currency and of the foreign and internal trade of the country, the importance of effectively organizing India's financial strength had become very great. The Gold Standard and Paper Currency Reserves had grown enormously and had been invested in London. The time had, therefore, come when a large State Bank had to be started in India either by the amalgamation of the Presidency Banks or independently of them. The State Bank would in no way have retarded the development of the ordinary banks; on the contrary, the position of such banks would have become more secure with a central bank to support them. There was enough capital in India to finance such a bank; and through its branches it was expected to keep itself in touch with the trade of the different provinces. It would, likewise, have taken up exchange business; and many of the difficulties which government experienced in this connection, under existing conditions, were expected to disappear.

1 See Webb's 'Advance India' and Report of the Chamberlain Commission.

248. The Amalgamation of Presidency Banks:—Almost all the projects formulated for a State Bank in India had taken the amalgamation of the Presidency Banks as the basis of their constitution, and the scheme suggested by Prof. Keynes also was founded upon the same idea The extent of the transactions of the Presidency Banks, the experience they had accumulated and the business relations they had established, rendered it impossible to keep them out of a scheme for a central bank of India and to erect a large national banking institution over their heads. And in fact, it was the difficulty of their coming to an agreement among themselves, with regard to amalgamation, that had stood in the way of the creation of the central bank. The Bank of England and the Bank of France are ordinary joint stock concerns, standing in special relation to the governments of those countries, and the Presidency Banks, combined into a new central bank could occupy the same position with respect to the Government of India.

One objection raised against the amalgamation of the Presidency Banks into a 'Central Bank' as distinguished from a 'State Bank', was that, being mainly under European control, the proposed Bank, though benefiting by large amounts of public money placed at its disposal, was not calculated to serve the interests of Indian merchants. The example of the Bank of Madras was cited to show how not a single Indian had been able to get on the board of directors of the Bank though its dealings with Indians had been large. Though latterly an Indian had been put upon the Board of the Madras Bank and the long-standing Indian complaint had been met, public opinion was naturally distrustful in matters where Indian interests were likely to be sacrificed and this distrust was not entirely without foundation. The Industrial Commission found it necessary to refer to the difficulty experienced by Indian industrialists in securing accommodation from the Presidency Banks; and it was not a groundless fear that under the management of the central board and the provincial boards of the Central Bank, on which Indian interests would not be adequately represented, the latter were not likely to be properly looked after and promoted. Then again, the amalgamated Bank was to leave the field of foreign exchange business to the Exchange Banks though it could have taken up the remittance business on behalf of the Secretary of State and secured full access to the London market. The powerful Exchange Banks have always resisted the encroachment of the

Presidency Banks on their preserve, and their monopoly was not going to be invaded. The note issue was, for the time being, not to be transferred to the central bank which was, however, to secure the reserve treasury and other balances of government. The scheme was, therefore, criticised as a half-hearted measure, not calculated to subserve public interests as a State Bank was expected to do.

The boards of directors of the three Presidency Banks submitted the scheme of amalgamation and the constitution of the Imperial Bank to their shareholders and obtained their sanction to the scheme early in 1920 in view of the necessary legislation that was proposed to be undertaken at the March session of the Supreme Legislative Council. But the introduction of the measure had to be postponed on account of the demand of members for time for the consideration of the important issues raised by it. The Presidency Banks pressed upon their shareholders the urgency of amalgamation on the ground that post-war economic developments rendered it imperatively necessary. The directors maintained that "failure to take advantage of the present opportunity to meet the undoubted public desire by amalgamating the three Presidency Banks in an Imperial Bank of India might result in Government being forced to establish a State Bank on purely official lines and to witdraw their connection with the three Presidency Banks." They also emphasised the danger of foreign banks obtaining a voice in the monetary affairs of India to the detriment both of Indian and British interests if the Presidency Banks did not rise to the height of their opportuniy and allowed the Indian field to be occupied by them.

249. Outline of the Scheme :—Excepting the management of note issue, and therefore of the Currency Reserve, and of the Gold Standard Reserve and the coinage of rupees, the Central Bank was to transact all the banking functions of government who would place all State balances at its disposal. It was not to compete with the regular Exchange Banks, but would nevertheless have facilities for rediscounting bills of exchange relative to Indian trade drawn in rupees or in sterling. The Bank's London office would prove of material help to its constituents in the matter of remittance and investments in London as well as the promotion of their commercial and other interests there. The Public Debt work would remain in the hands of the Bank and would be decentralised instead of its being centralized at Calcutta as under existing arrangements.

A central board, having under it local boards at the three Presidency towns, would be the governing body of the Imperial Bank and would consist of a general manager or two general managers, the Controller of Currency and the President and Vice-President of each local board and the secretaries and treasurers of the local boards, the latter having no voting power. The functions of the Central Board would be to deal with matters of general policy and it would have general power of control over the local boards. It would also determine the distribution of funds and the fixation of the Bank Rate and would be responsible for the publication of the Bank's weekly statements. The local boards would retain their existing constitution and would deal with the ordinary day-to-day business in their respective territories and new local boards might be formed at other centres in the near future. The Bank would undertake to start one hundred new branches in the course of five years from its establishment so as to develop Indian banking and to afford the public opportunites for investment.

The outline of the proposed scheme of amalgamation was as follows.—

"The total authorised capital with the reserve fund of the Imperial Bank of India will be Rs. 15,00,00,000 of which the authorised share capital will consist of 225,000, shares of Rs. 500 each representing Rs. 11,26,00 000 and the reserve fund Rs. 3,75,00,000. At the present time the fully paid up shares of the three Presidency banks are as follows :—

		Rs.
Bank of Bengal, 40,000 shares of Rs. 500 each	...	2,0000,000
Bank of Bombay, 20,000 shares of Rs. 500 each	...	1,00,00,000
Bank of Madras, 15,000 shares of Rs. 500 each	...	75,00,000
Total	...	3,75,00,000

It is proposed that paid up capital of the Imperial Bank shall be Rs. 5,62.50,000 and that the reserve fund shall be increased to Rs. 3,75,00,000.

To effect this :—		Rs.
The Bank of Bengal has to contribute share capital		3,00,00,000
Reserve	... ...	2,00,00,000
Total	...	5,00,00,000
The Bank of Bombay has to contribute share capital	...	1,50,00,000
Reserve	... ...	1,00,00,000
Total		2,50,00,000
The Bank of Madras has to contribute share capital...		1,12,50,000
Reserve	... ...	75,00,000
Total	...	1,87,50,000
Grand Total	...	9,37,50,000

For this purpose 150,000 new shares of the nominal value of Rs. 500 each will be issued by the Imperial Bank of India on which the sum of Rs. 125 will be payable. Out of this total issue, 80,000 shares will be allotted at par to the registered shareholders of the Bank of Bengal, 40,000 shares will be allotted at par to the registered shareholders of the Bank of Bombay and 30,000 shares to the registered shareholders of the Bank of Madras at the price of Rs. 225 per share. The result of this will be that each shareholder in the Bank of Bengal will exchange his present holding of shares for an equivalent number of fully paid shares in the Imperial Bank and, in addition, will receive two new shares at par of the Imperial Bank for every share so exchanged, on which latter new shares Rs. 125 will be immediately called up and payable; shareholders of the Bank of Bombay will make a similar exchange and receive a like allotment and the shareholders in the Bank of Madras will also exchange on the same terms and receive a like proportion of shares of Rs. 125 called up at the price of Rs. 225 per share. All future calls on the partly paid shares of Imperial Bank will be payable at par."

250. The Bank Act of 1920:—The amalgamation scheme received statutory shape and legislative sanction by the Imperial Bank of India Act (XLVII of 1920). We extract the following summary of the Act from the Report of the Currency Department for 1920-21:—"Under the new Act, the control of the Bank is entrusted to a Central Board of Governors with Local Boards at Calcutta, Bombay and Madras and such other places as the Central Board, with the previous sanction of the Governor General in Council, may determine. The Central Board of Government consists of:—

(a) Managing Governors, not exceeding two in number, appointed by the Governor General in Council on recommendation by the Central Board;

(b) the Presidents, Vice-Presidents and Secretaries of the Local Boards;

(c) the Controller of the Currency, or other officer nominated by the Governor General in Council; and

(d) not more than four non-officials nominated by the Governor General in Council.

Representatives of any Local Boards, which may be constituted, may be added at the discretion of the Central Board.

The Controller of the Currency and the Secretaries of the Local Boards are entitled to attend the meetings of the Central Board but not to vote. Under the agreement with Government, however, which will be referred to later, the Governor General in Council is entitled to issue instructions to the Bank in respect of any matter which in his opinion vitally affects his financial policy or the safety

of the Government balances, and if the Controller of the Currency or such other officer of Government as may be nominated by the Governor General in Council to be a Governor of the Central Board shall give notice in writing to the Managing Governors that he considers that any action proposed to be taken by the bank will be detrimental to the Government as affecting the matters aforesaid, such action shall not be taken without the approval in writing of the Governor General in Council. Under the Imperial Bank of India Act, provision was made for the increase of the capital of the Bank. The capital of the three Presidency Banks consisted of $3\frac{3}{4}$ crores of rupees in shares of Rs. 500 each, fully subscribed. The additional capital authorised is $7\frac{1}{2}$ crores in shares of Rs. 500 each, of which Rs. 125 has been called up, making the present capital of the Bank Rs. $11\frac{1}{4}$ crores, of which Rs. 5,62,50,000 will, on completion of the first call on the new shares, have been paid up. The reserve fund of the Bank is 3 crores 45 lakhs and on the 28th January, 1921, the first balance sheet showed the Government balance at Rs.7,96,50,000, other deposits at Rs. 76,43,40,000 and cash at Rs. 27,04,85,000 with a percentage of cash to liabilities of 31·94.

The Imperial Bank of India follows the Presidency Banks Act of 1876 in defining absolutely the class of business in which the Bank may engage, though the older limitations are modified in some minor points. It permits for the first time the constitution of a London office and the borrowing of money in England for the purpose of the Bank's business upon the security of assets of the Bank but not the opening of cash credits, keeping cash accounts or receiving deposits in London except from former customers of the Presidency Banks. The Act provides for an agreement between the Bank and the Secretary of State, and this agreement which was signed on the 27th January, 1921 and is for a period of ten years, determinable thereafter by either party with one year's notice, provides, *inter alia*, for the following important matters :—

(1) All the general banking business of the Government of India is to be carried out by the Imperial Bank.

(2) The Bank will hold all the Treasury balances at Head quarters and its branches. This involves the abolition of the Reserve Treasury system.

(3) Within five years the Bank undertakes to open 100 new branches, of which the Government may determine the location of one

in four. It may be mentioned here that the branches and agencies of the three Presidency Banks prior to the date of amalgamation numbered 69, including the Colombo branch of the Bank of Madras. The Bank of Bengal had no branches prior to the proposal to transfer Government business to the Bank in 1861–62, but no less than 18 branches were established before 1868.

(4) The management of the public debt will continue to be conducted by the Bank for a special remuneration.

(5) The Bank is entitled to transfer its funds through currency free of charge, and government will discontinue the issue of currency transfers or supply bills to the public between any two places in which a Local Head Office or a branch of the Imperial Bank is situated. The Bank in return undertakes to give the public every facility for the transfer of money between its Local Head Quarters and branches at rates not exceeding such rates as the Controller of the Currency may by special or general direction approve.

The maximum rates approved by the Controller of the Currency, which are uniform throughout India and Burma, for all telegraphic transfers or drafts issued by the Bank are as follows:—

For amounts of Rs. 10,000 and over...1 anna per cent.

For amounts of Rs. 1,000 and over but less than Rs. 10,000 ......2 annas per cent.

For amounts less than Rs. 1,000 the rates will be at the discretion of the Bank.

At the same time the opportunity was taken to bring the rates for government currency transfers and supply bills into line with the rates approved for the Bank, the rates previously having ranged from 1 to 2 annas between treasuries in the same province and from 2 to 4 annas between a treasury in one province and a currency office or a treasury in another province.

In certain respects, it will be observed, the Imperial Bank of India occupies the same position in this country as the Banks of England and France do in those countries. But there are important points of difference which ought to be carefully noted. Those

banks are bankers' banks enjoying the power of note issue as a monopoly, keeping the gold reserve of the country and performing certain well-defined and specialized functions. The Indian Bank had still to receive from the hands of government the operations connected with the note issue and its business of remitting funds between India and London.

251. Currency and Bank Rate:—One of the chief functions which the Imperial Bank was expected to perform was the mobilization of the monetary and credit resources of the country so as to make them available to trade and industry at a moderate, and as far as possible, uniform cost. The problem was not unlike what the Federal Reserve Board and Banks of the U. S. A. were constituted to solve. At the first stage of its development into a full-fledged national central bank, the Imperial Bank of India was enabled to use and employ more efficiently the balances of the government in this country. The questions relating to the elasticity of note issue and loans to banks from government's balances and reserves have been already discussed in preceding sections. The Babington Smith Committee approved the proposals formulated before it by Mr. Howard to the effect that, in order to provide for the temporary expansion of currency during the busy season, the note issue should be based, in part, upon commercial bills of exchange. It was recommended that notes up to 5 crores of rupees should be issued in the form of loans to the Presidency Banks on the collateral security of bills endorsed by the Banks and having a maturity not exceeding 90 days. The interest charged to the Bank for such advances was not to be less than 8 per cent. per annum; and the bills tendered as collateral were to be *bona fide* commercial bills against goods under export. The Committee did not look with equal favour upon internal bills "which may be created for purposes of finance or against goods held for speculative transactions", but had no objection to them provided connection with definite transactions in commodities could be established.

This recommendation was embodied in a suitable amendment of the Paper Currency Act, and government made rules regarding the procedure to be followed in giving effect to the provision. Two years' experience, however, showed that the object of the latter was not being attained and that loans at a lower rate of interest and in anticipation of monetary stringency, were necessary. The Cur-

rency Act was, therefore, amended again in 1923–24 and the limit of loans to be provided from currency, was raised from Rs. 5 to 12 crores, while rules were made prescribing that ' no loan should be made until the bank rate rises to 6 per cent. and that the entire amount of loans outstanding at any time should bear interest at current bank rate subject to the following minimum rates:—6 per cent. for the first four crores, 7 per cent. for the second four crores, and 8 per cent. for the last four crores. Further elasticity was imparted to the arrangement by the removal of the limit of four crores for loans at 7 per cent. so that subject to a minimum of 6 per cent. for the first four crores, Rs. 8 crores could be made available at the rate of 7 per cent. The full amount of Rs. 12 crores was lent in 1923–24, and the utility of the above change was demonstrated. The use of the mechanism of currency chests located at treasuries and sub-treasuries for transferring funds in order to facilitate the financing of trade has been described in the chapter on the Currency System. With the increasing assumption of the work of the transfer of funds by the Imperial Bank, the cash balances at government treasuries have been steadily reduced, and this result has been considerably assisted by the growing provision of currency chests at sub-treasuries.

Surplus cash balances in the moffussil treasuries can be transferred to head quarters and commercial centres without the actual remittance of coin or notes and the utmost economy of public funds can be effected by means of the above arrangement. The transfer of a certain amount from the treasury balance at a treasury or sub-treasury to the currency chest there, renders it possible to make a corresponding transfer from currency to government balances with the Imperial Bank, and the lock-up of funds is avoided.[1] The total number of currency chests at sub-treasuries went up to one thousand in 1925, and government balances amounting from three to four crores in 1923–24 were distributed over 1381 treasuries and sub-treasuries. The following table shows the distribution of government balances :—

1 "Under the present arrangements a telegram to head quarters intimating that a transfer to the currency chest has been made, enables surplus funds collected at a sub-treasury to be brought into use at once. The extention of the system of currency chests has, therefore, considerably increased the velocity of the circulation of the currency, particularly at the times when the staple crops are being brought into the market":—Report of the Currency Department, 1922–23.

Government Balances.

(In Crores of Rs.)

Year	Month	Balances at govt. Treasuries	Balance at the Imperial Bank of India
1921–22	June	5·5	22·1
	Oct.	4·8	8·9
	Jan.	4·8	11·0
	March	5·5	20·0
	Average	5·0	13·9
1922–23	June	4·2	16·6
	Oct.	3·5	13·1
	Jan.	3·8	18·2
	March	5·4	20·5
	Average	4·0	18·2
1923–24	June	3·3	12·5
	Oct.	3·2	7·7
	Jan.	3·2	16·9
	March	4·2	26·9
	Average	3·4	16·6
1925–26	March	4·2	27·4
	June	2·6	22·2
1926–27	Ap.	2·5	13·06
	Aug.	2·2	35·45
	Dec.	2·4	6·33
	March	3·1	24·62
1928–29	Ap.	2·1	7·14
	Aug.	2·1	16·92
	Dec.	2·2	7·73
	March	3·5	5·00

252. Imperial Bank Balances:—The expansion of the operations of the Imperial Bank has not produced the expected and the desired effect upon the monetary conditions in India to any appreciable extent, though it may be claimed that the close association of the Bank with government has helped to mitigate the seriousness of the seasonal financial stringency. The chief elements in the monetary position at any given time are (1) the agricultural conditions in India, (2) the demand for Indian staples abroad, (3) the state of government finances, (4) government's exchange

and currency policy, (5) the general tone of the industries and trade of the country, and (6) the public mood—confidence or distrust as to the possibilities of the near future as a result of political, social and economic developments. In 1921-22, for instance, the main features of periodical monetary stringency, from December, 1921 to April, 1922, when the Imperial Bank's hundi discount rate was 8 to 8½ per cent., were "the suddenness of the demand and the relative weakness of the government position in consequence of their revenue deficit and their statutory liability which involved deflation of the currency."[1]

In 1922-23, the bank hundi rate was 8½ per cent. in April, 7½ per cent. in May and 7 per cent. in June. It continued at 5 per cent. during the next five months and rose to 6 per cent. in December, 8 per cent. in January, 1923 and was 9½ per cent. in February and March. As the demand for the finance of the spring crops in northern India was of very short duration, the prolongation of the period of tight money in the earlier months, was accounted for "by want of confidence in the bazar due to the political situation, to the Government of India's budget position, to the piece goods deadlock and to the vague anticipation of more serious financial trouble," an additional factor being "the large purchases of Treasury Bills by the Banks in March, made in anticipation of easy money in April and the consequent squeeze in the middle of the month when money proved to be scarcer than had been expected." The financing of the movement and export of crops like cotton, jute, wheat and rice drains the resources of the Imperial Bank and its cash balances are considerably reduced thereby. For instance, the absorption of currency in the cotton areas between November and January often exceeds Rs. 20 crores and the removal of such a large amount of cash from the Bombay market forces up the money rates. The strain is relieved when money returns from up country in payment of bullion and other commodities and partly through Government transfers of revenue collections.

1 "On the other hand the close co-operation between government and the Imperial Bank after the critical period had set in prevented the development of anything in the nature of a serious crisis. In the absence of a strong central institution in close touch with government it is probable that money rates would......have been higher than they actually were".—Report of the Controller of currency, 1921-22.

There was serious monetary stringency in 1923-24, and the average bank rate was high throughout the year, the condition being extremely acute towards the close of the busy season. In 1926-27, the rate stood at 6 per cent. in April, was 4 per cent. from July to December and rose to 6 and 7 per cent. towards the close of the year. The financial stringency of the year 1928-29 is reflected in the comparatively small balances for that year in the table below. The character of the agricultural season, trade demand, floating of public loans and Government's action in the matter of currency supply, e. g. its deflation policy together determine the bank rate. The precautionary and remedial measures that are taken in this connection have been described above; and they do produce some ameliorating effect on the money situation. The cash balances of the Imperial Bank of India reflect the state of the money market; and the following detailed figures for five years will be found instructive :—

Cash Balances of the Imperial Bank of India.

(In Crores of Rupees)

In last week of	1921-22	1922-23	1923-24	1926-27	1928-29
April ...	28·16	18·04	16·53	25·31	9·8
May ...	26·41	19·40	17·66	32·85	11·8
June ...	30·45	33·92	28·40	41·44	13·4
July ...	35·73	43·23	36·28	56·57	22·7
August ...	33·06	44·98	39·57	59·05	25·0
September ...	29·71	36·73	39·40	50·39	23·4
October ...	29·24	33·46	36·34	43·40	18·3
November ...	24·68	27·03	24·58	37·39	14·5
December ...	13·56	15·48	17·04	20·92	11·2
January ...	16·91	12·61	16·15	17·00	12·4
February ...	15·98	14·50	15·01	16·22	12·0
March ...	20·48	14·44	18·20	18·80	10·8

253. India's Banking Position :—After the description we have given so far of the condition of banking in India, it is not necessary to repeat that the need of expansion in this connection is urgent. With respect to banking facilities and amounts handled by banks, there is no comparison between the position of India and that of western countries. That there is a growing tendency among the people towards banking their savings, investing them in shares of industrial concerns and in government stock and depositing them with the indigenous bankers or with joint stock and other banks, can not be doubted. But the use of cheques is restricted to large commercial centres and is rare outside Presidency towns and the major cities. The total aggregate deposits of British banks exceed £ 2400 million, which is nearly fifteen times the deposits in India. The deposits of one bank out of the group of the "big five" in Great Britain are larger than those of all the Indian banks put together! As banking economises the use of metallic currency, stimulates and mobilises national credit, encourages thrift, facilitates the transfer and exchange of wealth and assists trade and industry, the economic development of India must be conditioned by its expansion. It is through sound and enterprising banking that the natural resources of the country may be effectively exploited. A steadily increasing number of Indians must, likewise, be trained to organize and manage the country's credit operations and institutions and indigenous banking must be linked up to modern banking. The Imperial Bank has had to employ a steadily increasing number of Indians with the opening of new branches and it is stated that a systematic effort is being made to train Indians to serve the Bank efficiently. But the policy of the Bank in this and other respects, e. g. granting accommodation to shroffs and traders, has not inspired confidence in the minds of the people concerned. The present dependence of the country on foreign agency for its banking arrangements must be steadily remedied, and the finance of Indian trade, internal and external, will have to be managed and controlled by Indians themselves.[1]

England, the U. S. A. and Germany have evolved systems of banking peculiar to themselves and none of them can be slavishly

1 The public does not appear to be satisfied with the provision made by the Imperial Bank for the employment of Indians and a member of the Legislative Assembly even proposed amendment of the Imperial Bank Act for securing it.

imitated in this country. Political, economic and social causes are responsible for the difference. It will be a blunder of the first magnitude to ignore the importance of indigenous bankers who are to-day performing useful service to the community. But India can learn useful lessons by a comparison of her conditions and needs with foreign countries. The following extract from Mr. Dalal's note of dissent appended to the Babington Smith Committee's report will be read with interest:—India has an area of 1,802,657 square miles, and it contains 2,253 towns with 89,748,228 inhabitants and 720,342 villages with a population of 285,306,168. On 31st December, 1917, the total number of banking offices in India was only 402 and many of them overlapped in the larger towns. In fact, on that date there were, in the whole of India, only 165 towns which had banking offices. Canada, with a population of 8,460,000 has about 4,000 branches of banks. Further, there are 294,875,000 illiterate people in India, and out of the 18,539,778 literates there are only 1,670,387 literates in English." The following table shows the progress of deposits in the principal banks in India:—

Year	Presidency Banks (Imperial) Bank	Exchange Banks (Deposits in India only)	Indian Joint Stock Banks	Total
	Rs. (1,000)	Rs. (1,000)	Rs. (1,000)	Rs. (1,000)
1881	9,77,12	4,16,60	114 86	15,08,58
1898	15,92,12	10.15,31	5,[illegible]8,19	31,45,60
1906	30,[illegible]2,93	18,08,71	11,55.49	60,17,15
1910	36,58,01	24,79,17	25,65,85	87.03,03
1913	42,37,16	31,03,54	24 10,34	97.51,44
1914	45,65,60	30,14,76	18,37,12	94,17,48
1916	49,91,45	38,03,88	25,72,28	1,13.67,51
1918	59,62,03	61,26,33	42,14,83	1,63 03,19
1920	87,04,53	7,4,80,71	73,48,10	2,35,33,34
1923	82,76,45	68,44,22	47,69,32	1,98,90,05
1924	84,21,48	70,63,48	55,17,05	2,10,02,91
1927	79,27,45	68,86,23	64,29,69	2,12,43,37

Though he expresses the view that "there is a vast virgin field for the development and expansion of banking and for the collection into bank reserves of the innumerable stores of money lying idle throughout the country, which could be utilized for the benefit of

the holders and for the good of the trade and of the State," Mr. Dalal is careful enough to add that the expansion of banking in India must necessarily be slow and that "the Indian public can not be hurried and hustled in such matters." The illiteracy of the mass of the population, the predominance of agriculture and of rural life, and the low standard of living and poverty of the people are factors which must be taken into due consideration in the discussion of questions relating to credit and banking. The importance of co-operative credit societies lies in exploring and bringing into touch with modern banking a region where lack of organized credit and of opportunities for economic improvement has prevailed for long generations. The number and the transactions of provincial and central co-operative banks and registered non-agricultural co-operative credit societies, have been steadily increasing. In 1927-28, there were 16 co-operative banks, each having capital and reserve of 5 lakhs and over; and their aggregate deposits amounted to Rs. 8·8 crores. There were also 125 banks whose capital and reserve were in each case one lakh and below 5 lakhs of rupees and their aggregate deposits totalled about Rs. 13 crores. The total number of both these banks increased from 33 in 1918-19 to 141 in 1927-28, their capital and reserve from Rs. 65·2 lakhs to Rs. 3·9 crores and the amount of their deposits from Rs. 2·9 crores to Rs. 21·9 crores. The working capital of all co-operative societies together has gone up during this period, from Rs. 13·3 crores to Rs. 86 crores. Even with this increase the societies have been able to meet only a fraction of the needs of cultivators as inquiries of Banking Committees have discovered. The deposits with indigenous bankers and their aggregate funds can not be estimated, but they must be larger than the deposits of all the banks put together. [1]

254. The Prospects:—The Indian banking system consists, it may be stated in summing up, of the Imperial Bank at the top and the village sowkars at the bottom, with the Exchange and the Indian joint stock and co-operative banks and the shroffs in the middle. The proposed Reserve Bank, if and when it comes to function, will be the Bank of all banks and will control the country's credit and currency. The habit of depositing savings at a bank and using paper substitutes

1 Refer to evidence recorded by the Provincial Banking Inquiry Committees and to the investigations of the Central Cotton Committee regarding the finance of cotton.

and instruments of credit for money can grow only slowly. The war gave a stimulus to this tendency which was evident already before it among the people of the educated middle class. The extraordinary conditions of the war period had likewise a disturbing effect upon the public mind. The purchase of Post Office Cash Certificates which has now become very popular, created in that period in the public mind a distrust of such securities, which has taken a few years to disappear. A closer association of persons of all sections, communities and occupations with the system of banking is necessary to ensure a rapid and healthy growth. Mutual confidence, organization and the adoption of the more efficient modern methods of credit in all dealings, will be the conditions of progress, and there are indications that development is proceeding, though very slowly, along these lines.

Banks manufacture credit for their customers, and the two together make a small amount of cash go as far as it is possible to take it. The use of currency notes in internal circulation, for the financing of crops, is increasing, and they are taking the place of rupees in the finance of jute, rice, wheat, cotton and oil seeds. They are largely fiduciary money and their success lies in public confidence in encashment. The rural population does not indeed find notes convenient to keep and to handle; the 2½ rupees note never found much favour with the public and the 1 rupee note was not a good substitute for the silver coin. Nevertheless, the last mentioned note was a familiar feature of the bazars and was readily accepted by the shopkeeper, the craftsman, the cabman and the labourer. The notes of the higher denominations such as those for Rs. 5 and Rs. 10, have a wide vogue, and even in small towns much difficulty is not experienced now-a-days in negotiating them. The hundi is, of course, a common instrument of credit among tradesmen everywhere; and dealings in internal trade are being effected on a large scale through such bills. Overdrafts, cash credits and acceptances are naturally restricted to cities and the higher ranges of trade; but credit is being slowly democratised through such agencies as the co-operative movement and some of the more enterprising joint stock banks.

Cheques, which constitute fiduciary money that is not legal tender, do not yet form an appreciable proportion of the total circulation of the media of exchange in India. Their growth

depends upon the progress of modern banking and of deposits subject to withdrawal through their instrumentality. It is only the commercial, professional and other wealthy classes, who have regular banking accounts that may be drawn upon for payments, that make use of cheques. The opening of new branches by the Imperial Bank and by the joint stock banks is calculated to stimulate the use of cheques and save the movement of money and increase the velocity of currency circulation. Co-operative banks are now actively contributing to this progress, though indigenous bankers, as a rule, have nothing to do with them. Some idea of the extent to which cheques are used by the people may be had from the statistics of the clearing houses. The clearing house system is intended to save the trouble, time and money required to liquidate the indebtedness of banks to one another, created through cheques drawn by their customers and paid to their account. The transfer of funds is facilitated between a person who wishes to make a payment and the one who has to receive it if both have accounts at the same bank and only debit and credit entries need be made in the banks' books or if one has a banking account and the other passes on the cheque by endorsement or cashes it. The balance of banks' indebtedness to one another can be struck each day if their representatives meet together for the purpose, and the clearing house is the device used by them to that end. The dimensions of the clearings effected through the clearing houses in India will be seen from the following table :—

Clearing House Statistics.[1]

(In crores of Rs.)

Year	Calcutta	Bombay	Madras	Karachi	Rangoon	Total.
1914–15	266·9	157·83	18·8	11·6	43·1	498·3
1915–16	352·3	177·1	20·2	14·0	39·5	603·8
1917–18	524·9	383·5	23·0	22·1	52·8	1006 4
1919–20	1055·7	883·0	38·9	23·1	94·7	2090·6
1920–21	439·9	1315·9	73·7	33·4	104·8	2969·9
1921–22	905 0	906·7	39·5	36·7	122·0	2024·9
1923–24	853 0	707·9	55·4	41·5	132·0	1803·0
1925–26	1012·1	445·0	56·8	36·1	125·3	1688·5
1926–27	961·0	422·6	54·5	31·0	124·4	1609·5
1928–29	1094 0	652·3	65·7	28·0	125·0	1981·11

1 Figures for Cawnpore and Lahore are not separately shown in the above table.

The increase exhibited by the above figures over the pre-war transactions, is accounted for partly by the large payments which were made in connection with government loans, Treasury Bills, the sales of gold and the purchase of sterling drafts on London, partly by the prevailing high range of prices and partly by general economic progress. It is difficult to trace to what extent precisely cheques are being used in ordinary business transactions. The impression, however, is that their use is steadily on the increase. Payments are now-a-days made through them to contractors, to dealers of various classes and to the public funds. Cheques have now entered into co-operative banking, that is, into rural areas, and exemption from stamp duty has generally encouraged their use.

255. Central Banking System:—One serious drawback of the Indian monetary and banking system which struck the Hilton Young Commission, was the fact that under it the control of currency and of credit was in the hands of two distinct authorities viz. Government and the Imperial Bank. There was here a possibility of wide divergence of policy between the two authorities in the management of the currency and banking reserves and a consequent lack of unity in financial organization, so essential for monetary stability. The Commission thought that if the foundations of credit organization were to be truly laid in India, commercial banks, including exchange and indigenous banks, must be enabled, when the necessity arises, "to turn into cash a maximum of their assets with a minimum of disturbance to general conditions" and that this end could be achieved "only through the establishment of a central banking system, with the facilities of rediscounting it affords." Of the great western nations, the U. S. A. was the last to adopt such a system, and before 1913, suffered from all the evils inherent in decentralized banking and reserves. The characteristics of central banks are that (1) they have the sole right of note issue and (2) the responsibility of maintaining the stability of the currency. (3) They are the custodians of the currency and banking reserves and of the cash balances of their governments. (4) The special nature of their work requires that they should be prevented from transacting the every day commercial banking business of the country and from competing with the ordinary commercial banks. (5) But they are expected in times of stress to intervene in the business of the country by extending credit facilities on a liberal scale.

The Hilton Young Commission was strongly of opinion that "India, profiting by the experience of other nations, should perfect her currency and credit organization by setting up a central bank with a charter framed on lines which experience has proved to be sound." But could not the already existing and successful Imperial Bank be entrusted with this new role? The Commission's answer was a decisive negative. That Bank was performing its functions of a commercial bank efficiently and was making available to the community the increased commercial banking facilities so urgently needed and was rendering valuable assistance "in fostering among the people, as a whole, the habit of banking and investment." The hybrid character of the functions originally assigned to it, robbed it of much of its public usefulness, and it was necessary to relieve the Imperial Bank of the functions of a purely central banking character for being transferred to a new Reserve Bank. The Commission was not satisfied with a middle course which had been suggested and which had for its object "a gradual process of what may be termed "decommercialization" of the Imperial Bank. Under this proposal the Bank would be a true central bank in centres where adequate commercial banking facilities exist and it would continue to perform ordinary banking business elsewhere. There was no half-way house between the existing conditions and the establishment of an effective system of central banking. But the situation in India required special treatment all the same, and the Commission, therefore, stated that "the banking organization which India requires must be based, not upon a central bank alone as elsewhere, but upon a Central Bank and a great commercial bank which has government countenance to inspire confidence in it amongst an uninstructed public, and whatever government assistance is needed to enable it to perform the function of the initiator of banking facilities." The Commission framed the outline of a scheme of a Revenue Bank and of the charter it was proposed to grant to it.

256. The Reserve Bank:—It was proposed that, subject to the payments of limited dividends and the building up of suitable reserve funds, the balance of the profits of the Reserve Bank should be paid over to the government. The Bank was to be given the sole right of note issue for a period of 25 years, and not later than five years from the date of the charter becoming operative, government notes were to cease to be legal tender except at government

treasuries. The notes of the Bank were to be full legal tender and were to be guaranteed by government. The Bank was to be bound by statute to buy and sell gold without limit at rates determined with reference to a fixed gold parity of the rupee but in quantities of not less than 400 fine ounces, no limitation being imposed as to the purpose for which the gold was required. The conditions governing the sale of gold by the Bank were to be so framed as to free it in normal circumstances from the task of supplying gold for non-monetary purposes. The legal tender quality of the sovereign and the half-sovereign were to be removed and government was to offer "on tap" savings certificates redeemable in 3 or 5 years in legal tender money or gold at the option of the holder.[1]

The paper currency was to cease to be convertible by law into silver coin ; but the Bank must maintain the free interchangeability of the different forms of legal tender currency and the government must supply coin to the Bank on demand. One rupee notes were to be reintroduced and were to be full legal tender ; and notes other than this note were to be legally convertible into legal tender money, i. e. into notes of smaller denominations or silver rupees at the option of the currency authority. The silver rupee was to retain its full legal tender character. The Currency and Gold Standard Reserves were to be amalgamated and the proportions and compositions of the combined Reserve were to be fixed by statute. The "proportional reserve" system was to be adopted, and gold and gold securities were to form not less than 40 per cent. of the Reserve, subject to a possible temporary reduction, with the consent of government, on payment of a tax. The currency authority was to strive to work to a reserve ratio of 50 to 60 per cent. The gold holding was to be raised to 20 per cent. of the Reserve as soon as possible and to 25 per cent. within 10 years. The silver holding of the Reserve was to be very substantially reduced during this transition period. All the cash balances of government in India and abroad as well as the banking reserves of all banks operating in this country were to be centralized in the hands of the Reserve Bank.

The Government of India, which had already accepted and given effect to some of the more important recommendations of the Hilton

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1 With reference to these recommendations consult page 557 above.

Young Commission, adopted its scheme of a Reserve Bank and framed a bill embodying the main proposals. In the budget session of 1927, a joint committee of the two houses of the Indian legislature was appointed to consider and report on the bill. The Committee was sharply divided on the vital question of the constitution of the Bank. The Commission had adopted, in this behalf, the principle of resolutions passed both by the International Financial Conference of Brussels (1920) and that of Geneva (122), viz. that "Banks, and especially Banks of issue, should be free from political pressure, and should be conducted solely on lines of prudent finance." It had, therefore, recommended that "the Central Board would thus be composed of 14 members, of whom nine would be elected by shareholders, a maximum of three would be nominated by the Governor General in Council, and a Managing Governor and Deputy Managing Governor would also be nominated by the Governor General in Council." Government had based its provisions of the bill on this recommendation, but a majority of the committee decided to substitute a Bank with capital supplied by government in place of a Bank with private share capital. It was feared that a shareholders' Bank would be controlled by vested interests and would therefore fail to secure the confidence of the Indian public, and it was further argued that "joint stock principles are not suitable in the case of a Central Bank, the management of which should be carried on with an eye more to the public interest than to the accumulation of profit for shareholders."

The principal points in dispute between government and the majority of the Committee, representing Indian public opinion, related to the questions (1) should the Reserve Bank be a shareholders' bank or a Government bank whose capital is supplied by the State and (2) how should the board of management be constituted? The second question involved the consideration of the demand that members of the central and provincial legislatures should be allowed to be directors of the Bank and to elect members to the Board of management. These points were keenly debated and Government adhered to their original plan viz. keeping members of the legislature, and therefore political influence, out of the control of the Bank. The Finance Member was prepared, as a compromise, to accept the opposition's proposal of a State Bank without shareholders, if his constitution of the Board was agreed to. Various alternative schemes were, there-

fore, discussed while the Reserve Bank bill was on the legislative anvil in September, 1927, and in the course of the negotiations, the Finance Member proposed that Government would supply the Bank's capital by issuing stock worth 5 crores and that the public holding this stock would take the place of the shareholders. The discussion was, however, suddenly cut short, it was believed, by mandatory instructions from London, and the Finance Member, thus placed in a false position, had almost put in his resignation. The consideration of the bill was postponed, and the old grievance of the Indian public about undue interference in the affairs of this country of the authorities at Whitehall, found a fresh and a striking illustration. Sir Basil Blacket, who had defeated public opposition on the questions of the 16d. ratio and gold currency, had thus, for the time being, to curb his ardour while the goal was actually in sight.

257. Shroffs and Banks:—Since credit increases economic efficiency by stimulating the mobility of capital and by enabling the farmer, the manufacturer and the trader to obtain finance or purchasing power in anticipation of the completion and fructification of their productive activities, it is a matter of vital importance to a community that its savings should be collected and utilised to the best advantage through a suitable organization of banking. The system of Central Banking is calculated to conduce to the realization of this end by mobilising capital resources, by controlling and regulating the reserves, the currency and the credit of a country, by steadying the rates of interest through the bank rate and by stabilising the exchanges. It is recognised, therefore, that a central reserve bank will prove beneficial to India, as a decided improvement upon the existing disconnected and disunited system of currency and credit, provided, of course, it is properly co-ordinated with the indigenous system of banking and functions in a manner that is nationally beneficial and satisfactory to all the interests concerned. Apart from the fact that the Imperial Bank of India has not fulfilled expectations in this behalf, it is seriously doubted whether a central reserve bank will be able to discharge its chief functions successfully in the absence of local conditions favourable to its operations. The central bank can control and regulate credit by rediscounting commercial paper presented to it by joint stock banks which accommodate bill brokers. But in India, the branches of such banks and even of the Imperial Bank have

achieved little success in establishing a contact with the finance of internal trade and the indigenous banker. The link that connects the two is the "approved" endorsing shroff whose "hundies" are rediscounted upto limits fixed in each case. There are few "trade bills" which banks can discount on the endorsement of shroffs who generally rely on their own funds and resort to joint stock banks only when their resources are exhausted.

It will thus be seen that "the operations of the shroffs lie outside the influence of the organized Banking system of the country, and are on the whole, very little affected by the credit policy of the Banks"; and that "the Banks can not interfere to moderate the suddenness of the transition between excess and shortage, or *vice versa*". Such little control as is exercised to-day by the Government and the Imperial Bank, is rendered possible by their regulation of silver and note currency required in the bazars but when payment by cheques extends, "what means are available to secure for the Central authority an effective control over the credit operations of the bazar?"[1] The common 'hundi' of the indigenous banker is very often a finance bill, not based upon the actual movement of goods and is, therefore, not regarded as a suitable investment for banking funds. Mr. Gubbay whom we have quoted above, feels that it will be long before approved commercial bills play an important role in Indian banking as in advanced countries, and that in spite of the establishment of a central bank and efforts directed to modernise banking in India, "there will be lying beyond the influence and reach of the central authority a very considerable, perhaps a preponderatingly large amount of financial and commercial transactions which, in the hands of bazar dealers in credit, will be only indirectly responsive to Bank rate policy". According to him, the remedy lies in bringing about a modification of the present basis of the bazar "hundi" so as to render it acceptable to joint stock banks for the investment of their funds. What the banks want is self-liquidating commercial paper based on transactions in goods while such trade bills are met with in the bazars only to a limited extent. Sir Henry Strakosch who presided at Mr. Gubbay's lecture, held a more optimistic view and thought that "once the trader learned to appreciate that a bill representing an exchange of

1 M. S. M. Gubbay: *Indigenous Indian Banking*, a paper read at the Royal Society of Arts, London.

goods commanded a readier market and a better price, he would probably be most anxious to conform to the requirements of the banker" and that "if he were certain that the joint stock banks were always ready to lend on or discount true commercial bills by reason of the fact that the Reserve Bank of India was always prepared to discount them, there did not seem to be any reason to doubt that the shroff whose profit, like that of the bill broker in London, depended on turnover, would seek to acquire such bills wherever they could be found".

Among the Indian shroffs who borrow on hundies from the Imperial Bank and other joint stock banks, the Multanis or Shikarpuris are the most prominent. They both borrow and lend on *Mudati* hundies and receive from traders and sowkars hundies which are promises to pay after sixty or ninety days and which they get discounted at the Imperial and other banks. Shikarpuri shroffs carry on their lending business in Madras and Burma and finance agriculture, trade and small industries on short term paper. The *Mudati* hundi, or usance bill, is rarely used by other shroffs who generally employ the *Darshani* hundi which is payable at sight and is very largely used for purposes of remittance. If it is *Shahjog*, it must be paid to a *Shah* or a person of credit and substance in the market and it thus resembles a crossed cheque though it is something more than it. Joint stock banks are ever willing to advance money to traders on the security of goods stored in godowns under their control. They also lend to shroffs on demand promissory notes signed by two shroffs on their approved list or by one such shroff and one merchant, the limits of the amount of finance being fixed according to the banks' estimates of their standing. Advantage is taken of these facilities, which are confined to a few big business centres, only by a few shroffs and merchants. Indian bankers and dealers who ordinarily secure cheap credit in their own money market, treat this as a question of their honour and disapprove methods which are supposed to cast doubts on the soundness and the extent of their business and resent outsiders prying into their financial position. They, therefore, generally borrow from one another on current or fixed account and some of them go to banks as a last resort. Cotton, seeds and grain are partly bought in the villages or in a town market either by merchants and their agents direct or by *dalals* on behalf of merchants.

Payment is almost immediately made to the growers but the dealer or agent draws a *hundi* on his constituent immediately the goods are put on the rails. Advances can be obtained on the security of railway receipts which are not, however, negotiable, as hundies and trade bills are. The *hundi* is either locally negotiated or cash is sent down to the interior. The bulk of the internal trade is financed in this way through the unique instrument of credit, the *hundi*, which is a cheque, a promissory note and a bill of exchange rolled into one; and the problem now is how to link up this indigenous system with modern joint stock and central reserve banking. Shroffs have began to complain that joint stock banks, through deposits at their branches and Government through Postal Cash Certificates, are draining away funds from the moffussil to headquarters and crippling the resources of indigenous bankers. The favoured position of the Imperial Bank which competes with indigenous and joint stock banks, is equally adversely commented on. It is certain that branches of joint stock banks can not, for a long time to come, take the place of shroffs in the interior of the country where the latter are indispensable owing to their intimate contact with and sympathetic treatment of the people, big and small, concerned in trade and industry. The solution of the problem seems to lie in the direction of the banks coming into closer touch with the shroffs, using their credit machinery to the utmost, and consistently with the security of their funds, treating them in an accommodating spirit, and with greater sympathy and the shroffs, on their part, adjusting their methods to the needs of modern economic development and satisfying the requirements of banks and the public. Special facilities and responsibilities go hand in hand. In the changing conditions of the day, indigenous bankers require and deserve the support of the State and the public, and must, in their turn, strive to inspire confidence in the minds of the people whose deposits they have to attract and whom they have adequately to accommodate. Lack of cheap and convenient finance is felt on all sides in India, and everything which will strengthen the position of shroffs is calculated to assist the trade and the industries of the country. If Rs. 10 to Rs. 15 be taken as the average outside agricultural finance needed for each acre of land under crops in British India, 350 to 400 crores of rupees would be the total amount annually required for this purpose of cultivation alone; and an equal amount has to be found for moving staple crops to the markets and

to the ultimate consumers. This will show the magnitude of the size of agricultural finance and the importance of cheapening and facilitating it. There is besides industrial and household finance. Indigenous bankers and co-operative societies must be enabled to satisfy these requirements efficiently, and this must be made the chief aim of banking reform in India. There is enough dormant and potential financial capital in the country; only it needs to be mobilised.

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APPENDIX

SUMMARY OF IMPORTANT POINTS

I

It will be helpful to the reader if we sum up here our discussion of the important features of the existing organization of credit and banking in India and throw into relief its deficiencies and needs of development and reform. The separate treatment of co-operative credit and banking in the next chapter will, of course, complete the picture.

(1) The supply of purchasing power or means of payment for short or long periods in anticipation of reimbursement is an economic necessity and advantage. (2) This supply will depend on the size of public savings, the machinery for their collection and disposal and the price it will command. (3) The purpose and the period for which purchasing power is required and the security for its return to the person who offers the accommodation, will determine the price that must be paid for loans, that is, the rate of interest. (4) The lower the price and the greater the facility for obtaining "credit", that is purchasing power in anticipation of repayment at the time fixed, the more advantageous are the conditions in which economic activities, production, trade and consumption, are carried on. (5) For the seasonal operations of agriculture the landholder or cultivator, who has no savings of his own, and he is typical, receives loans on personal security or the security of the crops from the rural money lender or *bania* at fairly favourable rates of interest. (6) But if loans are needed for long periods, either for improvements or for non-productive uses e. g. domestic purposes. e. g. marriage ceremonies, security of lands and houses is demanded and the rates of interest may be higher. (7) What is true of agriculture, is equally true of handicrafts in which the artisan wants advances to buy raw materials. (8) Both the cultivator and the artisan mix up productive with non-productive credit and being ignorant, improvident and unbusinesslike, pile up indebtedness, mortgage lands and houses and are ever in danger of losing their independent occupations. (9) To safeguard his own interest, the sowkar, who is often also a trader, insists on acting as a middleman to his debtors, and the cultivator and the artisan have to sell the produce of their labour through him and be content with such prices as he offers. (10) Laws passed to protect the cultivator e. g. the Deccan Agriculturists' Relief Act, have worsened the debtors' position as, in self-defence the money lender either restricts credit or imposes hard conditions, taking sale deeds for mortgaged lands. (11) This state of things has been partially relieved

where co-operative credit societies have come to the rescue of borrowers. Government advances of *Takavi* under the Acts of 1883 and 1884, have been too meagre to prove effective.

(12) The town shroff, or the indigenous banker in the real sense of the term, is a man of standing and substance. He takes deposits, sells and discounts Hundis, makes remittances and gives short term credit for the financing of trade in agricultural and other commodities. (13) Rural traders secure short-term accommodation and remittance facilities through the shroffs and almost the whole of the internal trade is financed in this way. (14) The chief instruments of credit, negotiable instruments, employed in the indigenous money market are the Hundi, which is either *Darshani* (sight or demand bill) or *Mudati* (usance bill) and promissory notes. Hundis are *Shahjog Dhanijog* or *Dekhdnarjog* (payable to bearer). (15) Hundis, are bills of exchange or merely accommodation bills, payable on demand or on a fixed date after a stated interval. (16) There are bill brokers who act as middlemen in collecting and supplying Hundis. (17) There is considerable room for the improvement of this internal money market by the standardisation of the practices of shroffs, creating a discount market for hundis in the moffussil and stimulating dealings in real trade bills. (18) Only to a very small extent, are traders' hundis rediscounted by the shroffs with joint stock banks. (19) The need of improvement is now being felt by the indigenous bankers themselves who feel the competition of the Imperial Bank of India, other joint banks, the government's borrowings through the post office and co-operative banks. (20) To-day, it is only when in the height of the busy season there is financial stringency that shroffs go to the Imperial Bank for purposes of rediscounting and only a few shroffs care normally to borrow from the Imperial Bank on personal and other security. (21) Only a few shroffs like the Multanie have regular dealings with the Imperial Bank which rediscounts their hundis up to fixed total limits granted to them. They are induced to do so by the higher rates at which they can lend monies borrowed from the Bank, at a rate two per cent. higher than the Bank Rate. (22) How to adjust the indigenous banking machinery to the modern type of banking represented by the joint stock banks and the Imperial Bank of India is the great problem to be solved. (23) If trade bills, bank acceptances and similar other instruments and devices common to western banking, come into regular use, the problem may be solved. (24) The main idea is to coordinate the financial resources of the whole country, to bring them into a common reservoir, as it were, and to distribute them evenly wherever they are wanted. (25) This will facilitate trade and industry and lower the price which the cultivator and the artisan has to pay for his loans.

(26) Indian joint stock banks are modelled on the western pattern and are largely made use of by advanced industrialists and traders for accommodation and are patronised by the educated and intelligent middle class of

people. (27) Their deposits, loans granted by them and cheques drawn on them are growing slowly in importance. But this institution has not yet been placed on a firm and secure foundation. (28) Lack of experience, mismanagement and a restricted sphere of operations have retarded their progress, but the movement, though checked by prevailing depression, is steadily advancing. (29) Some of the Indian banks are being efficiently managed, and the number of new concerns, on a small scale, is slowly increasing. Some shroffs and sowkars of the old type are also taking to this kind of business, and this is a promising line of the development of Indian banking. (30) The bigger banks discount bills and hundis, lend on the security of goods, government paper, gold and property and attract deposits, thus encouraging the saving habit among the people. (31) They complain of the privileged and monopolistic position occupied by the Imperial Bank of India and the unfair competition they have to encounter from it. (32) The Imperial Bank occupies to-day a curious position, partly that of a central bank and partly that of an ordinary commercial bank. (33) The shroffs and the cooperative banks as well as the joint stock banks allege that that State-aided Bank has far from succeeded in doing the work expected of it and that its rivalry impedes the progress of banking in India. (34) The result has been that while indigenous banking has deteriorated, Indian joint stock banks have not been able to take its place and the Imperial Bank has not done the work of co-ordination. (35) The Exchange Banks have the monopoly of the finance of foreign trade, and there is a feeling in the country that this branch of banking which is carried on to a large extent with the help of Indian deposits, should be steadily brought under Indian influence and into Indian hands. (36) The costly and non-Indian administration and unsympathetic management of the Imperial Bank are subjects of strong adverse comment; and Indian nationalism insists on radical changes in both these respects. (37) The proposed central Reserve Bank of India will bring little improvement unless it is in a position to function as a truly national central bank, and to bring into its ambit the joint stock banks, the present Imperial Bank, which will become, under the changed conditions, a large and influential, but an ordinary joint stock bank, the indigenous bankers and co-operative banks. (38) Government's borrowing policy will likewise have to be brought in a line with the new system. (39) It is an important point to consider whether in a large country like India the American system of Federal Reserve Banks will not be more suitable rather than the other system of one centralized national bank. (40) It is also a suggestion worth considering whether some of the bigger shroffs, either individually or jointly, may not be employed as the agents of the Imperial or the central bank, under adequate safeguards, to do banking business in up country places where a joint stock bank is not likely to prove successful. (41) Agricultural and land mortgage banks is another direction that Indian banking has now to take if the country's agricultural industry is

to prosper and expand. (42) The question of industrial banks, small and large, can not be neglected and must be considered along with other aspects of Indian banking. (43) In assessing the size of banking in India, in comparing it with the banks of western countries and their branches, the number, the resources and the operations of indigenous bankers are not often taken into account and the poverty of Indian masses is forgotten.

II

(a) The Indian Central Cotton Committee carried out inquiries in eight different cotton growing areas in relation to the finance of the cotton crop and the following is a summary of general conclusions based upon facts and figures collected:—

(1) On an average about 70 per cent. of the cultivators in each area required loans.

(2) It is not difficult for cultivators (except those in Sind) to obtain adequate finance for cultivation and non-cultivation expenditure.

(3) Borrowing was substantial, but not excessive, except in Sind and Madras where the "index of borrowing" (as explained in the report) was 50 (or over) and 47 respectively.

(4) Borrowing is confined mainly to the peirod at or just before the commencement of cultivation operations.

(5) It would appear that a considerable percentage of the borrowings is for non-cultivation purposes, but it is not possible to give even a rough figure.

(6) The *sowcar* is the most important financier of the cultivator, being responsible for 67 p. c. of the total amount lent. The next source, the landlord or zamindar, lent only 15%.

(7) The co-operative credit movement has made much headway in Berar and Khandesh; there is great scope for development in Sind and in the Punjab; but in areas like Gujarat and Madras (Western and Northern tracts) where cultivators are able to obtain loans as readily and cheaply from *Sowkars* and Landlords, there appears to be less scope for the establishment of societies.

(8) The *dalal* or the agent of the big cotton merchant or firm does not take any direct part in financing the cultivators.

(9) 55 per cent. of the total loans were obtained at 12 p. c. interest or less, which can not be called unsatisfactory. With regard to the rates of interest charged, the position is worst in Sind and best in middle Gujarat.

(10) Lenders as a rule do not require any security for loans, e. g. by way of mortgage of land, crops or moveables. In Sind, however, and to a small extent in Khandesh, borrowers were required to give a written undertaking to sell their *Kapas* to or through their lenders.

(11) Except in Sind, cultivators are, in general, not hampered by their borrowings, either as regards the persons to whom, or as regards the time at which, they may sell their *Kapas*.

(b) The following are briefly the conclusions regarding village sales of cotton :—

(1) Cultivators, except in Berar (where there are regulated markets) show a decided preference for sale in the village as opposed to the market.

(2) Sale organisation in the village, is on the whole, satisfactory. Payments are usually prompt.

(3) The usual method of disposal is to sell outright.

(4) Village or itinerant petty traders are the principal buyers.

(5) The weight systems are very confusing.

(6) Weights used in villages are usually crude.

(7) Contrary to popular opinion, rates in the villages approximate very closely to those in the market.

(8) Advance sales are very few.

(9) Early sales are small compared with late sales (except in Sind and North Gujarat). Contrary to the common belief, cultivators can and do hold their crops for considerable periods.

(10) Very few cultivators ginned their *Kapas* and sold lint.

FINANCE & MARKETING OF CULTIVATOR'S COTTON.

(c) The following are the principal findings of the investigation into the finance and marketing of the cultivator's cotton crop in the Punjab :—

(1) 51.3 p.c. of the 1820 cultivators recorded borrowed money which was taken before or at the beginning of cultivation operation.

(2) The amount borrowed per head of borrowers was Rs.628/-.

(3) As in the other investigations, credit to proprietors is more easily obtained and the amount of debt is much higher amongst them than amongst tenants, being Rs. 818 per head of propriteor debtors and Rs. 412/- per head of tenant debtors.

(4) 68 p. c. of the sums borrowed were taken from Sowcars, 8.8 p. c. were advanced by Co-operative Societies, 16.9 p. c. by Zamindars, 3 p. c. by relatives and 3 p. c. by artis.

(5) 67 p. c. of the loans were taken at 20 p. c. interest or less, 27 p. c. at between 20 p. c. and 30 p. c. and 6 p. c. at over 30p. c. interest.

(6) 72 p. c. of the crop was sold in the villages, the chief purchaser being the village bania who bought 83. 4 p. c. The rest was bought by ginowners through commission agents.

(7) Village sales are preferred to sales in the market because (i) the inconvenience of taking the produce to market; (ii) the lack of accurate information about rates; (iii) the suspicion aroused owing to the secret settling of rates; (iv) the artis act chiefly in the interests of the buyers; and (v) vandhas—disputes resulting in deductions are agreed to by the artis without the consent of the seller.

(8) There are no regulated and organized markets in the Punjab. Kapas is either sold in the ordinary markets or in the ginneries.

(9) Sales are effected throughout artis who enter into a bargain with the buyers under cover. Contract sales are common in the Multan District.

(10) 26 p. c. of the carts brought to market on the days investigations were made belonged to growers and 74 p. c. were brought by village banias or traders.

(11) In Chak Jhumra market in the Lyallpur District 50 p. c. of the Kapas was brought by growers. Here the artis work in the sellers' interests and no deductions are permitted after the rate has been fixed.

(12) Vandhas or disputes are common in the other markets and deductions up to 12 annas a maund are often imposed.

(13) Weighment is usually done on beam scales and with pucca weights so that no complaints were received regarding false weights.

(14) Market charges fluctuate between annas-/13/- in Sonepat to Rs. 3/8/- per cent. in Lyallpur where a ginning 'pool' worked successfully in the interests of the buyers.

APPENDIX

MACLAGAN COMMITTEE'S REPORT.

A student of co-operation in India will find in the report of the Maclagan Committee a source of useful information and guidance, and we commend to the reader a careful perusal of that document. From the report he will see what success the movement attained during the first decade of its existence, what were the strong and the weak points of its organization and working and what results it was thought capable of achieving. He will also derive from it a clear understanding of the nature and the composition of the structure of Indian co-operation and will be enabled to take a comparative view of the present condition of the movement in the light of the state of things depicted in the Maclagan Committee's account and recommendations, though these refer to a state of things prevailing fifteen years ago. We can offer here only a rough and brief summary of that report :—

INTRODUCTORY

The report starts with a description of the depressed condition of the lower classes and of the remedial measures attempted by the State to improve it, and it observes that this action having proved partial and incomplete, Government turned to co- operation as the most useful method of dealing with the problem before it. The moral aspect of co-operation is then emphasised and it is stated that to true co-operation alone it is that "Government must look for the amelioration of the masses, and not to a pseudo-co-operative edifice, however imposing, which is built in ignorance of co-operative principles." The development of the co-operative movement is then traced from its inception to the time of the appointment of the Committee. The report proceeds thus :—

It was inevitable in the beginning that credit societies should be mainly attended to but that a demand for noncredit forms of co-operation should arise was in itself a healthy sign. But such societies should arise spontaneously and satisfy a real need and a competent staff should be available to supervise them and deal with the complicated economic problems involved. Several non- agricultural and noncredit societies have been started for sale, purchase and other purposes. Societies for the benefit of weavers are welcome, but attempts to reorganize village industries on a more profitable basis should not be undertaken sporadically or fortuitously. Certain types of societies like stores, often exhibit a tendency to ignore the moral basis of co-operation and care should be taken by the Registrar that co-operative-

principles are followed by such societies, and that they do not become merely commercial and profit-hunting bodies.

Though the primary object of the co-operative movement was to tackle the agrarian problem through it, it is necessary that non-agricultural societies also should grow up along with the agricultural. The wage-earning, artisan and middle classes must be brought within the co-operative fold. Middle class urban banks are not strictly co-operative, but in the absence of joint stock banking facilities they are likely to serve a useful purpose. With regard to banks for the use of large landed proprietors, corresponding to Land Mortgage Credit Associations, the establishment of well-conceived and well administered banks of this type "would be a measure of great value not only to the proprietors themselves but also to the Government."

PRIMARY SOCIETIES

In the case of Primary societies it is on three main requirements that their soundness is based, viz. (1) they must be co-operative; (2) they must also be businesslike and (3) they must be thoroughly well supervised. The area must be sufficiently restricted to enable members to exercise an effective mutual control, and their number should not be unduly large. Before a society is registered, a scrutiny should be made into the kind of men it will deal with and their assets, working capital and so on. Teaching of co-operative principles in various ways must be arranged and proper men must be selected for the post of secretary and as members of the managing committee. Some provision is necessary for ascertaining the previous debts of members and, wherever possible, they may be gradually paid off rather than that they should be immediately cleared on admission. As regards the rate of the progress of the movement, there should be no attempt at forcing the pace and "except for special reasons, an increase in the number of societies should radiate from existing centres of co-operation and should be based on a well-informed desire to imitate existing good examples."

The capital of primary societies is composed of four items, (1) shares, (2) deposits, (3) loans and (4) surplus assets or reserve fund. The value of shares should not be unduly large so as to create disabilities against poor members and a maximum limit should be fixed to dividends. Value of shares may be deducted from loans granted to members and the principle of unlimited liability or rather "contributory unlimited liability" should be adhered to in the case of agricultural credit societies. The amount of deposits locally obtained has been comparatively small; and "unless as the movement progresses, there is a substantial increase in this class of deposits it will have to be confessed that co-operation has failed in one of its main objects." Compulsory deposits from members are not desirable; and the term of deposits should not ordinarily be less than one year. Only two exceptions to this rule may be admitted: (1) short-term deposits are useful for temporary accommodation to meet demands for loans, and (2) savings

deposits when small sums within strictly marked limits are taken and dealt with on lines similar to those of the Post Office Savings Banks.

The total borrowing powers of a society are fixed by the Central Bank and the Registrar, and the amount the society can lend is determined by this limit. But it is necessary for a society to fix the limit (1) up to which members as a body will pledge their liability and (2) to which members should individually be entitled to receive loans. Loans are given for the ordinary operations of agriculture and much assistance cannot be expected from co-operation for expensive improvements for which recourse must be had to Government. Periods for which loans should be given must be carefully worked out in view of the objects for which they have been made. Personal security ought to be the rule and sureties should be made to realise their responsibility. The mortgage of land should only be regarded as collateral security in addition to sureties.

The competition of societies has brought down the rates of outside money-lenders. 'So long as the rates of societies are below those of the outside market, they cannot be regarded as excessive and there are many dangers in sudden or large reductions below such rates'. It must be emphasised that 'unless loans are repaid punctually, co-operation is both financially and educationally an illusion; and no exertions are wasted which aim at ensuring promptitude in this respect.' Disputes as to arrears should be referred to the Registrar and if he so directs, to arbitration. The Act provides for this arrangement. There is, however, a great difficulty in securing execution of decisions; but it will not be advisable to accord to societies the privilege of summary procedure. An effort should be made to build up a reserve fund so as to make the society ultimately independent of outside help. The surplus assets or reserve fund may properly be employed in the business of the society so long as proper provision is made for the necessary fluid resources. Under the Act one-fourth of the net profits must be carried to a reserve fund and 10 per cent. of the remainder may be used for any charitable purpose with the sanction of the Registrar.

Periodical audit and constant supervision are necessary and for this purpose the official machinery must be sufficiently powerful. The audit must be comprehensive and thorough and should be carried out under State control at the present stage of the co-operative movement. The time is distant when the work of making the original audit can be taken up by societies themselves. The work of supervision should be carried out by unions, central banks and other bodies maintained by the societies themselves.

CENTRAL BANKS

Though the operations of a 'central bank' may cover a larger area, it is usually expected to finance primary societies within a single district or part of the district. Between such a bank and the primary societies, there is in some Provinces, the link of 'guaranteeing unions' and their number in Burma is

large. "The union is registered as a society with limited liability and mutual guarantee is effected by a rule that each guaranteeing society shall be liable for default by a society in the repayment of a loan recommended by the union to the extent of the maximum amount of its borrowings from non-members in the twelve months preceding a call." This kind of union is to be strongly recommended as it will be a great accession of strength to the movement.

Central banks perform the double function of balancing (1) the funds of societies and (2) supplying capital. There are now practically no Central banks which undertake outside business and comparatively few which lend to individuals, but the time seems to have come when steps should be taken to bring to a close in all cases the practice of granting any loans except to registered societies. A Central Bank should cover as large an area as is compatible with convenience and efficiency. Under existing conditions it is much better to adhere to the system of independent central banks than to have branches of Provincial Banks. No loans should be granted to societies which are not share-holders. All shares held by individuals should be fully paid up and the use of reserve liability is to be deprecated.

The total liability attaching to shares, whether held by individuals or societies, should be limited to their face value. A maximum rate should be fixed for dividends, but it should be laid down on some logical principle. The deposits of these banks will not seriously compete with those of joint stock banks. Amounts held on current account should be covered by sufficient fluid resources. Savings accounts may also be opened but certain precautions must be observed. The area from which deposits may come, need not be restricted. The central banks may receive advances from Presidency Banks and joint stock banks in the form of cash credits. The system of debentures is not to be much relied upon in this connection. Loans to individuals are to be deprecated and central banks should not undertake any outside banking work. Credit of societies to which loans are to be made, should be carefully assessed, particularly where there are no unions in existence, and the objects of the loans must be similarly scrutinized.

The period of loans must be conditioned by the period for which deposits are held, as the former, unlike the latter, is within the control of the Central Bank. Unfortunately the practice of many banks is not in accord with this sound principle. Cash credits should be given to societies which are thoroughly well managed and co-operative in character. The security required from societies for loans should ordinarily take the form of pro-notes and not the shares held by them in central banks. Every society and bank must have a reserve fund under the Act, but besides the Reserve Fund proper, which in the case of primary societies, is built up out of the indivisible net profit, there are the 'fluid resources' which must be carefully husbanded in order to enable societies and banks to meet the demands of depositors. In the absence of facilities for discounting co-operative paper this

fluid resource should, in central banks, be sufficient to meet half the deposits due for payment within the next twelve months, a standard of one-third being held sufficient in the case of Provincial Banks.

PROVINCIAL BANKS.

In each of the major provinces there should be one apex bank which will co-ordinate and control the working of central banks; and they should be prohibited from dealing with each other or with Presidency or joint stock banks except through its medium. The Provincial Bank should itself be obliged to confine its dealings with co-operative institutions to Central Banks and leave to them the work of dealing with societies. The present organization throughout India is incomplete in this respect. Although in starting a Provincial Bank individual share-holders may have a preponderating influence, representing the business element, its constitution should be so framed as to give to affiliated co-operative institutions an opportunity at no distant date of securing a majority of votes at the general meeting.

The management of a Provincial Bank requires more expert knowledge and experience than that of a Central Bank, and it is desirable that the management should be mainly in the hands of business men. All central banks should be induced to become affiliated to the Provincial Bank, and the latter should grant no loans to societies capable of being affiliated to a Central Bank. Long-period deposits are necessary to Provincial Banks which should gradually accumulate surplus assets and good liquid securities in order that dependence on outside agencies may be diminished. Their fluid resources should be sufficient in amount to cover one-third of the possible liabilities of the Banks falling due in the course of the ensuing year.

The main business of a Provincial Bank should be to coordinate and control the finances of Central Banks, utilizing their surpluses and supplementing their deficiencies, and they should not embark in business outside the co-operative movement except in so far as it may be found necessary to lend or deposit spare funds for short periods in outside institutions.

GENERAL

It may be generally stated that if provision is made to minimise undue official influence the movement should not be deprived of the moral and financial support which Government servants give it. None of the powers of the Registrar should be devolved upon the Collectors. In certain Provinces the Collector or sub-divisional officer is the chairman of a Central Bank. This practice is found to be beneficial and has its obvious advantages but these officers should not hold positions on the managing committees of central banks *ex-officio* or as an invariable rule. The district officer "would stand as a well-wisher, equipped with the requisite knowledge and sympathy, but

need not necessarily have any intimate connection with the management or assume direct responsibility."

It is necessary to co-ordinate economic departments of Agriculture, Industry and Co-operation under a single officer of high standing in each Province, to be called the Development Commissioner. There should also be an advisory agency at the head-quarters of Government to deal with the many technical and complex problems which are arising in connection with co-operation. The officer should be attached to the Government of India and he should make inquiries and tender advice. Agricultural loans made by Government under Act XII of 1884, and Act XIX of 1883 should be granted to co-operative societies themselves. There exists no agency in India "which can be relied on to provide the facilities of rediscount for co-operative banks, and thereby give to their finance that elasticity without which present stability and the same progressive development of the co-operative movement appear to be difficult if not impossible." Commercial banks will not voluntarily undertake this work, and if some arrangement cannot be made with the Presidency Banks under which they will undertake the duty of rediscounting agricultural paper for Provincial co-operative banks, the only alternative solution appears to lie in the establishment of a State co-operative apex bank.

CHAPTER XV

RENT, LANDLORD AND TENANT.

276. National Income :—We have so far considered questions relating to the production and circulation of wealth, and must now proceed to discuss certain problems concerning the distribution of wealth. Satisfaction of material wants is the motive of economic activity; this latter results in the production of wealth; and the gratification of desires can come only through the acquisition and consumption of the cherished objects or services. Consumption is the object of all wealth-creation, and the wealth produced by a community, must be distributed among its members in order that it may be consumed. The wealth produced by the co-operation of the various participants who supply the essentials of production, constitutes a reservoir out of which those agents take out their shares.[1] Goods and services produced and rendered to satisfy the wants of the community by means of land, labour and capital, are the source from which these agents are remunerated. Each agent has a claim to a share in the common stock, and naturally an increase in the total product means and ought to mean augmentation of these shares. The remuneration which the landlord receives for his contribution to production, is called rent; interest is the remuneration of the capitalist, and wages are the payment received by labourers. The *entrepreneur* or organizer who brings together the agents of production and carries on the enterprize, is also rewarded with his share which is called profit. Specialisation in production has now proceeded to such a length that different classes in the community have come to control different agents of production, though a combination of these last in the same hands is not uncommon. Shares in the national dividend obtained by these classes, correspond or should correspond to the contributions made by them to the production of wealth. And the

1 "The labour and capital of the country, acting on its natural resources, produce annually a certain net aggregate of commodities, material and immaterial, including services of all kinds. This is true, net annual income or revenue of the country or the national dividend."—**Marshall : Principles of Economics.**

remuneration of each contributor is determined by the social demand for his services. Except in the case of agriculturists, people seldom engage themselves in the production of commodities that directly satisfy their wants. Even all the food products needed by the farmer can not be produced by him, and he cannot consume all that he produces, e. g. surplus food grains, cotton, oil seeds &c. In this way, each produces what he can and throws it, as it were, into the social stock and takes out of it for his own needs, what he is allowed to abstract. Take the simple case of an Indian peasant. When he harvests his crop, so many people go to his threshing floor to ask for a share. The money-lender and the tax-gatherer are there; there are the farm hands and the artisans who made and repaired agricultural implements for him. All these have contributed to the making of his produce, and some have been paid for their services in advance of the harvest.

In a previous Chapter[1] we remarked that the problem of production is the most important in India, that of distribution being comparatively subordinate. But this does not mean that the remuneration received by the different participants in wealth-creation is satisfactory or that it has no bearing upon the economic condition of society. And if one of them takes more out of the common stock than is due to him, the others have to suffer and their loss not only causes injustice and hardship but is likely to affect adversely the aggregate production, and therefore, the interests of the community as a whole. Production and distribution will thus be found, at bottom, to be interdependent. Hence the need of equitable and economically desirable distribution of wealth. The older economists trusted too much to the beneficent operation of free competition but the domination of one class over another has led, especially under modern forms of organization of industry, to inequalities and to the rise of capitalism and socialism. So long as agriculture was the principal means of wealth-production, the effort of every one was directed to the acquisition of land or control over its produce; and distribution took place according to the degree of that power possessed by individuals. The state of things has been undergoing a visible change and other forms of wealth-production are assuming greater importance, with the result that the system of wealth-distri-

1 Pages 78–79.

bution also is observed to change. The tenant and the labourer in India have not had their due while the landlord and the capitalist have become wealthy and powerful. Being unorganized, the former have had to be left to shift for themselves and have now been protected by the State in several particulars.

277. Wealth–Distribution :—Except when persons and families are self-sufficient, producing wealth for their own consumption, a constant exchange of commodities and services must take place among the members of a community. Distribution would present no difficulties if each person, without the co-operation of others, secured everything he required. Though it is true to a certain extent that the cultivator in India produces for consumption rather than for profit, nevertheless it will be found that even in the most primitive village, (e. g. Bhil communities in Khandesh and Dohad) the peasant requires goods which he can not produce and has to engage the services of labourers and use the goods manufactured by weavers, potters and blacksmiths; and this need of exchange is greater in proportion to the progress of society, with its differentiation and specialization of functions. People are thus perpetually creating wealth in various forms and rendering services which go into a common stock, as it were, and they draw from it their share determined by the value of their own contribution to the community's aggregate income. The supply of these commodities and services contributed by individuals is itself the demand for other commodities and services; and this process of the filling up and depletion of the common reservoir is constantly going on though it may not always be obvious to everybody.

If we exclude those who can not contribute to wealth-production, e. g. children and old men and those who will not produce or render services, (beggars and thieves) other persons will be found to work in order to secure necessaries, comforts and luxuries. These latter are received in exchange for what they contribute to wealth-production. The fact that the remuneration is received in the form of money, does not alter the fundamental nature of the distribution of wealth. On what principle this distribution should take place and how the share of each contributor to the national income should be determined, are questions which have long been debated. The general law of value viz. of marginal productivity or of scarcity, of supply in relation to demand, is taken to be the regulator of distri-

bution.[1] The law of demand and supply, that is competition, is the main regulator of the shares, though the justice of this allotting of shares has been challenged. Communists and socialists would give to each person according to his needs or deserts, but these are not easy to determine; and besides the difficulty of making an equitable distribution, there is the other consideration about the effect of the alternative methods of distribution, upon production, and therefore upon the national dividend, which will be available for distribution. This has an important bearing upon the condition of the community.

The inequality, the injustice and the comparatively unsatisfactory conditions of life which are involved in the uneven distribution of wealth, under the existing industrial system, have raised most difficult problems for which various solutions are being proposed; and they are responsible for most of the industrial unrest which prevails all over the world. It is now commonly agreed that without impairing the efficiency of production and weakening the stimulus to economic enterprise, each contributor to wealth-creation ought to be enabled to secure a decent amount of remuneration and that monopolistic earnings and incomes obtained at the cost of other members of society, should be rendered impossible. Custom was long the regulator of distribution in India and inequalities were suffered because they were regarded as inevitable. But with the growing prevalence of the modern economic conditions, competition is coming to play a more important part and with it a reaction in favour of equality and fair allocation of reward for services. A fair and equitable remuneration of different kinds of work has been the social ideal in all countries for centuries. But what constitutes fairness and equity in distribution when different classes and grades of labour have to be dealt with, and how justice should be done to all, has been difficult to determine, and consequently landlords, capitalists and middlemen have been able to secure a comparatively larger share of the wealth produced by the community. As distribution of wealth is bound up with the organization of its production, socialists propose to bring about equality by nationalization or the social ownership of the instruments of production, viz. land and capital.

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1 See Seligman : *Principles*; and Cassel : *Sozialokonomie.*

278. Estimates of Income:—In our chapter on Production and Population,[1] an attempt has been made to estimate the total food production of India, and now we must form an estimate of the total income of the people. Accuracy in this matter is unattainable in view of the absence of the relevant statistics and only a rough guess is all that may be expected. Reference must, however, be made to the different estimates, some times widely varying from one another, which have been made, and a comparison of the per capita Indian income with the corresponding figures for foreign countries, will prove suggestive. The national incomes of the leading countries of the world were estimated by Dr. J. C. Stamp for the year 1914 as follows (we have added an estimate for India):–

Country		Amounts in Mil. £.		Amount per head of population (in £)
United States	...	7250	...	72
United Kingdom	...	2250	...	50
Germany	...	2150	...	30
France	...	1500	...	38
Austria-Hungary	...	1100	...	21
Italy	...	800	...	23
India	...	**750**	...	**3**
Japan	...	325	...	6
Canada	...	300	...	40
Australia	...	258	...	54
Spain	...	230	...	11

It will be seen that though India stands low enough from the point of view of the quantity of absolute total income, she sinks to the bottom when the average per capita income viz, £ 3 is considered. The method of calculating the national income will be apparent from the figures given on pages 290 to 295, and the nature of the net income or dividend is explained below. It must not be forgotten that estimates of money income are subject to important reservations, and accuracy can never be claimed for them. The sense in which the terms national dividend and national income are to be understood and the method by which estimates regarding them are

1 **Pages 290–295.**

to be framed, are likewise matters of dispute among economists. National income may be found by adding up the incomes of people as they are subjected to the income tax; or the earnings of the members of the various occupational classes of the public may be added together; or a census of production may be taken as the basis for computing the net income of the nation. Then again, difficulty is experienced in estimating the value of intangible forms of wealth, viz. services, and these are excluded as such from the calculation of production and are not separately considered on the ground of their being covered by incomes derived from the tangible wealth produced by a community. This is not, however, strictly correct in as much as the remuneration of the services of physicians, lawyers, teachers, clerks and other servants is not included in the value of gross production and must, therefore, be separately counted. Whether singers, pleaders and actors should receive large incomes, is another matter and is a question of consumption more than one of distribution. If the several incomes of different classes are added together, the equation of national dividend would require that services should be shown on the side of production. It must be remarked here that in arriving at the national dividend or net national income, we must guard against counting items twice over.[1]

From the aggregate national income of India are deducted sums which are not actually available for distribution among the people of the country, e. g. home charges, interest and profits on foreign capital invested in this country and net remittances made on private account by foreign residents &c. or for the support of Indians abroad. But it should not be forgotten that some of these items represent services (whatever one may say about them) which are available for distribution among the people and are consumed by them. The question of the "drain" of a part of India's annual production of wealth or the "tribute" which the country's political and economic position imposes upon its people, which arises in this connection, has been discussed in a previous chapter and we have indicated there the significance of the technical equivalence between the services rendered to India by foreigners and coming into this country in the form of "invisible" imports and the exports of merchandise that are set off against them. Subject to the deductions mentioned above,

1 Read "Wealth and Taxable Capacity of India" by Shah and Khambata.

the total national income of British India may be taken approximately at Rs. 2,100 crores or Rs. 84 per head of the population for 1921–22. Professors Wadia and Joshi[1] estimate the net per capita income for 1913–14 at Rs. 44 and Prof. Shah and Mr. Khambata put the gross income at Rs. 74 for 1921–22. These figures, representing money income, must change with varying prices, and the above figures of Rs. 2,100 and Rs. 84 would now be reduced to less than Rs. 1,638 and Rs. 63.

In a preceding chapter[2] we have estimated the total yield and value of food crops for the year 1921–22. If we now add corresponding figures for non-food crops we shall obtain a rough idea of the total agricultural production in British India for that year, except for certain items to be presently mentioned. The combined figures may be presented as below:—

Crop	Million Acres	Million Tons	Value in Crores of Rs.
Total Food Crops	*214*	*78*	*1052*
Oil seeds	14	2	70
Cotton	11	$\frac{9}{11}$ (or $4\frac{1}{2}$ million bales)	80
Jute	$2\frac{1}{2}$	$\frac{5}{7}$ (or 4 million bales)	26
Other Crops	12	4	60
Grand Total	256	89	1,288

The extent of the acreage and the yield has widely varied in later years e. g. figures for jute and cotton, the production of which has, in some years, been 6 and 10 million bales respectively. In the above statement we have slightly rounded off the figures in cases where they were abnormally low in the year selected. But in accordance with the allowances made in framing our estimate of food crops, for the reason that only a few of the crops normally rise to the standard level of yield and that in one part or another of each Province there is annually insufficient or unseasonal rainfall, and frosts and locusts not unfrequently damage the crops, it will be only

1 "The wealth of India."

2 See pages 292–295.

fair to reduce the aggregate outturn by one-fourth to one-fifth so as to arrive at the true average agricultural income of the people. This leaves us with a total of Rs. 1,000 crores. To this must now be added the value of supplementary farm produce such as cattle, milk, fodder, straw, hides &c. which may be reasonably taken at one-third of the main agricultural outturn. Care must here be taken not to bring items to account twice. The cultivator can not, for instance, both sell his fodder and maintain his cattle with it and get value for milk and manure as well as for cattle food. It should be similarly noted that the gross market value of agricultural produce we are dealing with, includes the charges and therefore the income of middlemen like traders. The latter must not, therefore, be counted again. It will be a liberal estimate to add Rs. 400 crores on account of the additional items referred to above and to bring up the aggregate agricultural income to Rs. 1,400 crores for British India. No allowance has been made here for seed used up and for the depreciation of equipment.

The total non-agricultural income is generally taken at one-half the value of agricultural outturn. This was the basis of Lord Curzon's estimate and it appears to be quite generous. In a poor and agricultural country like India, the proportion between agricultural and non-agricultural production can not be higher than two-thirds and one-third. This estimate is borne out by a study of family budgets among the rural people and the working classes. We, therefore, add as the contribution of people engaged in industries, in professions and in service, Rs. 700 crores and get for the final total of national income the figure of Rs. 2,100 crores, with a per capita income of Rs. 84. As the general index number of prices has gone down from 180 to 140 since 1921-22, we must reduce the above figure by over one-fifth to arrive at the final estimate of the present national income which, therefore, is Rs. 1638 crores; and distributed over a population of 26 crores in British India, it gives Rs. 63 as the income per head. It is not necessary here to compare and comment on the various estimates of income which have been attempted by investigators with reference to particular villages and districts and for the whole country as well. It need only be stated generally that if the estimates are taken with the necessary allowances and reservations, they will be found to approximate those we have given here.

279. Land Rent :—We now proceed to consider the shares taken by the principal contributors to wealth–production from the total annual output. Incomes are now-a-days distinguished as "earned" and "unearned" in accordance as they are due to actual work done by labourers, managers and organizers and are derived from the land or capital that may be placed at the disposal of producers of wealth. It has been already pointed out that the participants in the creation of wealth receive remuneration in different forms and that rent, interest and profits are received for the supply of land, labour capital and organizing capacity respectively. The word 'rent' is used in common parlance to connote the price for the use of a thing *e. g.* a house, a machine or a carriage. But more often it is associated in the popular mind with the price paid or obtained for the use of land. This income from land is independent of the returns received for the capital invested or the labour expended, and the theory which explains the emergence of land rent is famous in Political Economy. Pure economic rent is the income received by the owner of a property as a result of the advantage it enjoys in the matter of situation, productivity or other qualities over other properties and is not earned by either the capital or the labour of the owner.[1] It is not an imaginary case but an actual fact that there are lands which yield no income, independent of the return to capital and labour. A person cultivates a piece of land and the outturn of crops may be just enough to pay the wages of hired labourers, the interest on capital borrowed and the prices of necessaries required to maintain the owner while at work on the land. This is the economists' 'no rent land.'* As pure profit is to be distinguished from the reward for management, pure economic rent must be clearly marked off from wages of labour and interest of capital put into the soil. The actual rent received by the owner of land may be more or less than the economic rent according to the intensity of the demand of farmers or tenants. It is the price demanded and paid for the use of the productive properties of the soil. These remarks apply to land used as building sites or play grounds as much as to agricultural lands. Land which is

1 "Rent is due to natural variations in soils, or to the varying advantage given to sites, not by the owners of the sites, but by the distribution of population and the means of transport. If the payment of rent were stopped, the fertility of good soils and the convenience of good sites would not diminish: for the rent-receivers did not create and do not maintain that fertility and that convenience."—Henry Clay : Economics.

unfit for cultivation and lying at a distance from human habitations will yield no rent, but the rents of land that may be used for houses and factories fetch high rents.

This traditional conception of rent is now held to be too narrow, and it is shown that rent in the sense of a differential gain, is not restricted to land income but may be present in profit and wages as well. It is demonstrated that there is absolute as well as differential land rent, and it is stated that rent is the price paid for a service and varies according to scarcity in relation to demand. We have discussed the theories of land rent exhaustively in the Appendix to this chapter to which attention is invited. The comparative utility of land determines its varied and varying values, as in the case of other forms of wealth. Land is a gift of nature, but it has to be appropriated and made fit for producing crops or serving as building sites. Rent of land increases as demand for it rises and the advantage of fertility or situation tends to enhance it. This character of land rent, the limited supply of land, the national and economic importance of the food and raw materials land produces, the social effects of the possession of land by a certain class in the community, all these factors have invested the question of rent with a peculiar interest. How land is held and owned, how it is hired out, how its produce is distributed and how the community is affected by land laws and land rent, are questions which have raised difficult problems in all countries. Schemes of land nationalization and of a single tax on land, have been discussed and the heavy taxation of land and absorption by the State of 'unearned increment' have been advocated. India is not free from controversies regarding questions of this nature. The alleged injustice of the permanent settlement of land revenue with Bengal Jamindars, the admitted necessity of safeguarding the interest of the tenants against those of landlords and the dispute regarding the advisability of the periodical revision of land revenue settlements, are subjects of perennial discussion. It is, therefore, necessary to deal here with the question of the land tenures which prevail in India, particularly because agriculture is the predominant industry of this country and the walfare of the mass of the population depends on the system of land tenure and the share of the rayats and tenants in the produce of the lands they cultivate. For a similar reason we have also discussed the problem of the land tax in the following sections in association with rent.

280. Hiring out Land:—The proprietor of land may either lease it to farmers and tenants or may cultivate it himself. If the land belongs to the community *e. g.* waste lands, government is the proprietor and leases it to tenants, who pay rent to it. If private individuals are proprietors, they receive the rent from their tenants. Where the first system prevails on a large scale and the bulk of the land in the country is supposed to belong to the State, there is complete nationalization of land which is the ideal of socialists, who regard landlords as parasites. The second system prevails pre-eminently in England where the land is owned mostly by private proprietors. Hence the agitation in that country against unearned increment and for the nationalization of land. The economic as well as the political trouble in Ireland was due chiefly to absentee landlords from England who owned big properties there. Thirdly, the proprietor may cultivate the land himself, and France is the classical example of this system which also prevails in America and to a large extent in India. It is a system which is highly praised by economists and is held up to the imitation of nations where tenants cultivate the lands of proprietors.

As rent is not remuneration for labour or service and is not therefore 'earned', socialists want to transfer the monopoly gain of landlords to the community. It follows from the very nature of rent itself that even if the whole of it were confiscated, land would still continue to be cultivated and that is why unearned income is taxed at a higher rate than earned income. But it must be borne in mind that the abolition of private property in land and other instruments of wealth-production is apt to destroy the motive to work and to save. Under certain circumstances, farm tenure is economically beneficial and socially unobjectionable. If the landlord takes interest in his land, puts capital into it and improves it, the fact of its being let out to a farmer can not be urged as a disadvantage of the system. Where substantial farmers take land on lease and cultivate it intensively, the system is productive of benefit to all concerned. But such landlords are few, and generally land is neglected and tenants are oppressed. In the hands of a peasant prorietor, on the other hand, owing to "the magic of private property," land is profitably cultivated and from the point of view of the peasant as well as of society, this is very desirable. Only the peasant must be in a position to carry on cultivation as a

business proposition. Even where land is hired out, the Metayage system,—under which the rent is payable in kind instead of in money and consists in a proportion of the crop instead of being fixed for a term of years,—is preferable.

More has perhaps been written about the systems of land tenure in India than in any other country, and it is after a prolonged and elaborate investigation and discussion that the rights of various parties such as the State and the different grades of landlords and of tenants, have been determined with anything like precision. The institution of land-ownership has undergone numerous changes, in many places almost revolutionary, in the vicissitudes of the history of this ancient country. Waves of immigration, colonization, conquest and usurpation have left abiding traces on the systems of land tenure which consequently present a complex appearance; and the early years of British rule, with its inexperience and lack of knowledge, combined with a determination to obtain securely, a considerable amount of revenue, only added to the prevailing confusion. Similar change of ownership is proceeding, though slowly and perhaps imperceptibly, before our eyes. For more than 160 years, these questions have been debated, and though a good deal of definiteness has been attained during the past generation or two, even now the controversies are not at an end. Many held and hold to-day that the State in India is the universal landlord, and therefore the land revenue received by government is not a tax but is a rent which a proprietor may claim from his tenants. They, therefore, feel that land nationalization, which is only a distant and perhaps an unattainable ideal in other countries, is an accomplished fact in India except in those places where the government has deliberately conferred the proprietorship of lands upon individuals. It is, therefore, usual to exclude land revenue from the calculation of the amount of the burden of taxation that falls upon the people, as it is supposed to constitute rent which tenants have to pay to the landlord, whether he is a private individual or the government.

281. State-Landlordism:—State landlordism in India is not a mere theory; it underlies the land revenue policy of government in actual practice in a large part of the country. If the State is the landlord, it is entitled to take away the whole of the rent, leaving to the occupant the ordinary profits of agriculture which in practice may

amount to bare subsistence and little more. Land rent is not always pure economic rent, being sometimes less than it, and government in India, though it considers itself as the universal landlord, does not presume to take the whole of the rent but only a share of it. It is not officially denied that the portion of the income from the land claimed by the government formerly was excessive and that the State demand was steadily moderated.[1] Lord Cornwallis's Permanent Settlement proceeded on the principle that the State was the proprietor of the soil. In that capacity it renounced its rights to a progressive share in the rental of the land. But it was the *rent* which was renounced; it was not *revenue*.[2] Mr. Wilson told the Legislative Council in 1860 that 'land revenue could only be regarded as rent,' and Mr. James Mill spoke in 1831 of *rent* of land in India having always been considered the *property* of government. Though few have the hardihood now to reiterate the theory of state landlordism in all its nakedness in the face of its repudiation by authorities like the Court of Directors of the British East India Company, the Secretary of State for India and responsible officials and others who have studied the question closely, the land revenue policy of the State is actually animated by that exploded belief and veiled references are made to it from time to time.[3]

The assertion is found repeatedly made that land has, in the East, belonged to the sovereign from time immemorial, and that the British government in this country only accepted the principle and followed the practice of the old rulers, having stepped into the shoes of the latter. The 'survey tenure' of the Bombay Presidency is described as the right of occupancy of 'government land' continuable in perpetuity on payment of government demand and transferable by inheritance, sale, gift or mortgage without other restrictions than the requirement to give notice to the authorities. John Briggs[4] has examined the subject at great length and combated the assertion about the State being the universal landlord in the East. He observes:— "The preceding portion of the book has, I trust, proved that the occupant of the land was alone its sole proprietor; that the demand

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1 See Government of India's Resolution on Land Revenue Policy, 1902.

2 Sir Louis Mallet.

3 See G. V. Joshi's Writings and Speeches, page 573.

4 The Land Tax in India.

on him for contributing to the support of the State, was a sort of income tax, viz. a limited portion of the produce of his estate and that this portion was fixed in time of peace but liable to increase in time of war and that under all circumstances, it left a certain surplus profit to the owner, equivalent to a rent. Moreover, I hope I have established that the sovereign never claimed to be the proprietor of the soil, but of the land tax he collected through local agents and expended it in such a way as the Government thought fit."

In a despatch to the Secretary of State, dated 8th June, 1880, Lord Lytton's Government observed:—"We do not accept the accuracy of the description that the tenure (of land in India) was that of cultivating tenants with the power to mortgage the land of the State and that land is the property of government held by the occupant as tenant in hereditary succession so long as he pays the Government demand. On the contrary, the sale and mortgage of land were recognized under the native governments before the establishment of British power...It has been one of the great objects of all the successive Governments of India since the days of Lord Cornwallis, if not to create property in land, at all events, to secure and fortify and develop it to the utmost. The Government undoubtedly is the owner of a first charge the amount of which is fixed by itself on the produce of all revenue-paying land in India; but over the greater part of the Indian Empire it is no more the owner of cultivated land than the owner of a rent charge in England is the owner of the land upon which it is charged. If the charge is fixed so high as to leave nothing for the cultivator, such a maintenance as will keep him from deserting the land, it may of course be said either that property in land does not exist or that it is worthless." The old rulers never claimed to be the proprietors of the lands of their subjects, and for the expenses of government took a certain defined share of the produce of the fields, estimated at from one-tenth to one-sixth. The Mahomedan kings followed this practice and sometimes may have raised the share to one-third. So long as the tax was taken in kind, the system was most elastic, and in fact, the actual collection was adjusted to the yield. Even when in later years the grain share was commuted into money payment, the same elasticity was maintained and government rarely worked up to the standard rates laid down. Government land was clearly distinguished from the property of

private individuals; and rules regarding the rent and the tax respectively taken from the two were definitely laid down and uniformly observed.

282. **Alleged Hindu Theory** :—Property in land in India, as elsewhere, vested in private individuals, is not, of course, complete and is subject to the superior right of the State. But many people who want to make out that the government in this country already owns all land and that land nationalization, which is the aim of socialists in other countries, is here, an accomplished and an accepted fact, rely for a decisive authority for their view, upon stray references to the subject in ancient Sanskrit works, on the practice which despotic chiefs and princes adopted in the troublous times which preceded the advent of British rule and on the land tenure system which prevails in Indian States. Mr. Vincent Smith, for example, has taken great pains, in his History of India, to prove that land has belonged to the ruler in this country from time immemorial.[1] He quotes a remark of Abbe Duboi to the effect that in Malabar alone has proprietory right been preserved intact and that every where else the soil belongs to the ruler, the cultivator being merely his tenant. Baden Powell's criticism of this view may be read with benefit.[2]

Mr. Smith also cites the testimony of a commentator of Chanakya's Arthashastra who declares that those who are well-versed in the scriptures, admit that the king is the owner of both land and water, and that the people can exercise their right of ownership over all other things except these two. But he altogether ignores the fact that the whole chapter in which the remarks commented upon occur, is devoted by Chanakya to the description of the duties of the Superintendent of Crown lands, who, he says, 'shall employ slaves, labourers and prisoners to sow the seeds on crown lands which have been often satisfactorily ploughed.' It is but natural that rent should be taken by the king's superintendent for the cultivation of crown lands from the tenants who are set to work them for want of an adequate supply of labourers working for a wage.

Mr. Vincent Smith proceeds to state that Kautilya appears to endorse the view of the commentator of his book alluded to above

1 The Oxford History of India, page 90.
2 Land Systems of British India.

because of his instructions to the king that 'lands prepared for cultivation shall be given to tax payers (Karada) only for life (ekapurushikani)' and that 'lands may be confiscated from those who do not cultivate them.' But again, Mr. Smith does not care to consider the connection in which the above instructions are given by Chanakya. The chapter in which the author of the Arthashastra is represented as having supported the state proprietorship of land, is entitled 'formation of villages,' and at the very outset states how, 'either by inducing foreigners to immigrate or by causing the thickly populated centres of his own kingdom to send forth the excessive population the king may construct villages either on new sites or on old ruins.' This is obviously a deliberate creation of royal villages in which the ruler may rightly claim to be the owner of lands and it does not prove the state ownership of all lands. It should, besides, be noted that Chanakya's system of polity peculiarly borders on State socialism in certain important respects and that it is not supported either by other authorities or by the common custom of the country in ancient times.

As a result of his careful and extensive study of the land revenue question, Mr. Baden Powell has deduced the conclusion that the theory about the state-ownership of land in India, is untenable. Despotic kings, pretending to be divinely appointed to rule over the earth, could, of course, claim the proprietorship of any body's land or even all land. But this was a despot's fiat and not a legitimate claim. Similarly, relentless conquerors appropriated the land of the vanquished and made it their own. Mr. Hopkins[1] who holds the interesting view that 'the king owned the land, but did not draw rent from it,' asserts that there was a gradual tendency in India, which can be traced in legal literature, to regard the land of the peasant as belonging to him entirely and to resist the king's despotic claim to proprietorship. Brihaspati speaks of the king's taking away a man's land as if it was a natural calamity which it was no use complaining about but which had to be meekly submitted to. But he goes on to state :—"When land is taken from one man by the king actuated by anger or avarice on using fraudulent pretexts, and bestowed on a different person as a mark of his favour, such a gift is not considered as valid." Why is not such a gift valid if all

1 **"India, Old and New," page 225.**

land belongs to the king? The law-giver, however, proceeds to observe:—"When (however) land is taken from a person enjoying it without a legitimate title of ownership, and is given to a worthier person, (the latter) must not be deprived of it."[1]

283. Right of Proprietorship:—The British officers who were confronted with the task of revenue management in Bengal in the last quarter of the 18th century, were totally ignorant of the old system of land tenure and of taxation. They were confounded with the chaotic condition into which the province had been thrown and the conflicting claims which were put forward to proprietorship of land. Old records were searched and scrutinised and different systems of assessment and collection were tried. But the confusion continued both as regards the amounts of revenue and the persons from whom they were to be realized; and at last Lord Cornwallis felt that there was only one way out of the difficulty, and it was to recognize the hereditary landlords, the descendants of old chiefs and collectors and farmers of revenue, viz. the Jamindars, as proprietors who were to be held responsible for the payment of the dues of government.

Baden Powell has given an extremely interesting account of the different ways in which, in the course of history, rights of proprietorship developed in the different parts of India. The old rulers levied a tax on all lands except those which were deliberately exempted from it, viz. lands possessed by court favourites or persons who were rewarded or remunerated for their services to the state, or religious institutions. Jahagir and Inam lands were of this class. Lands really belonged to those who or whose ancestors had cleared and reclaimed or appropriated them. But with the turns of the wheel of fortune, in times of foreign invasion and in civil wars, these proprietors were dispossessed and were reduced to the condition of tenants. The conquerors and usurpers were themselves, later on, made to give up their ownership when another wave of invaders or immigrants came, and they became only inferior proprietors or tenants of a superior kind. The king's right to receive a tax or revenue from land, must be clearly distinguished from a proprietor's right to receive rent from cultivators. Rulers could alienate either the first or the second where it existed and also both. The first could be converted into

1 **Brihaspati, XIX, 18,22,23.**

the second by force or fraud; and the transformation of a collector or farmer of revenue under agreement with government, into a landlord, was confirmed by lapse of time or official recognition.

Old princes and chiefs who were brought under subjection, were often, as a matter of policy, continued in possession of their lands on condition that they collected and paid into the public treasury the tax levied upon the occupants of land, the subjects of the new sovereign government, deducting and reserving a certain share thereof for themselves. Territories on the frontiers of kingdoms and principalities were handed over for management to capable persons on similar terms. Farmers of revenues and revenue officers of government often made the land whose revenue they collected, their private property. Leaders of turbulent and restless tribes took advantage of the confusion of the times and also became private proprietors. To resettle or colonise parts of the country which had been devastated, enterprising persons were encouraged by governments to lead colonization movements and to establish peaceful administration. Such persons came to acquire rights of overlordship. Several families of Jamidars and Talukdars thus came to have a share in the produce of the fields cultivated by inferior holders and tenants. They and village leaders were recognized by the British government who settled with them what they were to pay to the State out of the rents they received. Blocks of lands were leased to the highest bidders and the Jamindari right was sold to new contractors for arrears of revenue.

231. Different Tenures:—The first two generations of British rule in India were spent in experiments in land revenue settlement. In Bengal the State dealt directly with landlords, and the tax levied on them was made permanent. This system was also adopted in north Madras. But in the North-Western Provinces, proprietors of large estates, Mahals or villages, jointly held by them in certain shares, were recognized and a lump assessment was levied on the rents received by them. In the Punjab land was generally held by peasant proprietors living in village communities, each village collectively paying the land tax, which was revised at each new settlement as in the North-Western Provinces. Government in Madras was inclined to recognize such village communities they found in existence there though the ties which bound the proprietors of land were not like those in Northern India, ties of blo

and common ancestry, supposed or real, but ties of a long residence in the locality and of common interest. But the village community there was not recognised and was broken up when the Rayatwari system was introduced in the Madras Presidency.

In the Madras Administration report for 1855-56, rayatwari is thus explained :—"Under the rayatwari system every registered holder of land is recognized as its proprietor and pays direct to Government. He is at liberty to sublet his property or to transfer it by gift, sale or mortgage. He can not be ejected by Government so long as he pays the fixed assessment and has the option annually of increasing or diminishing his holding or of entirely abandoning it." The system in Bombay is also rayatwari and the so-called "occupant" of "government land", is as much a proprietor of his land as his brother, the Jamindar of Bengal, the only difference being that in the case of the latter, the land tax is perpetually fixed whereas in the case of the former, it is liable to periodical enhancement. In Bengal, the Jamindar had been the descendant of a territorial ruler, a rent collector or a farmer of revenue; in Bombay, the rayat was himself the proprietor. In Madras, the Government itself has stated :—"the distinguishing feature of rayatwari is the limitation in perpetuity of the demand of the State on the land. The rayats have thus all the advantages of the Zamindari tenure while the State has a valuable reserve of waste land, whence as cultivation extends, its resources will be augmented so as to meet the increasing demands on its finances which the progress of the country will entail : and in practice this leading principle of rayatwari has never been infringed." But this principle of the rayatwari system has been ignored in Madras and Bombay, and at each periodical revision, the land tax is screwed up on the implied principle that the State is the landlord and is entitled to receive an increasing amount of rent from its tenants.

We are not concerned in this place with the financial or the administrative aspect of the land systems. Our interest is restricted, for the moment, to the amount or the proportion of the rent derived from the land and the classes of people who receive it. Questions pertaining to land revenue, its assessment and settlement and its relation to the policy of the government, have a close bearing upon the principal subject of this chapter viz. the share of the owners and holders of land in the national dividend, and have, therefore, been

referred to. Three points must here be noted:—(1) The person with whom the State has settled its land revenue is the proprietor of the land, be he a Jamindar, a village community or a brotherhood or a peasant cultivating his own land and in whatever manner the right of proprietorship may have been acquired. There may be inferior proprietors under them or proprietors having superior rights over them. The status and the rights of these have been now settled and their shares have been fixed. Cases of cultivators who have taken government land, waste or otherwise, on lease, on specific conditions, e. g. restricted tenure in Bombay, are, of course exceptional. (2) In Bengal and a part of Madras, the amount to be taken by government out of landlords' rents has been permanently fixed; elsewhere the tax levied upon the Jamindar, the joint village, the brotherhood, the Malguzar and the Talukdar, is subject to a periodical revision and is a certain proportion of the rental or net "assets"; and in the case where the State deals direct with the actual cultivator, that is, under the rayatwari system, the tax is supposed to be a share in the net produce of each field and to represent a portion of the rent of land which whould go to a middleman like the Jamindar if one stood between the rayat and the State. (3) In all these cases the rents collected by landlords including the State, are regulated as to amounts by definite laws and rules, so that there may be no arbitrary enhancement. The rents of tenants who are not protected by special laws, may, however, be increased at the pleasure of the landlord.

285. Effects of the System:—The economic significance of these features of the principal systems of land tenure in India lies in their effect upon the condition of the agricultural industry and on the incomes of the cultivating classes. We must also discuss this question of the creation and the emergence of middlemen landlords in relation to another species of economic revolution that is proceeding apace viz. the steadily increasing number of rent-paying tenants even in Provinces in which the Jamindari system does not predominate, as a result of the pressure of population on land and the growing competition of people having no other occupation, for opportunities to earn a livelihood on land. "......even in the Punjab, which is a land of small peasant proprietors, in the quinquennial period ending 15th June 1927, out of 29·7 million acres under cultivation, 16·5 million acres were held by tenants paying

cash and grain rents."[1] In the United Provinces, three-fourths of the land is cultivated by tenants. In that Province cash rents are nearly the rule, but elsewhere e. g. in the Punjab and Sind, the *batai* system prevails, and under it, the tenant has to pay to the landlord usually one-half of the gross produce. As the tenant has to bear the cost of cultivation and the landlord has not, the lion's share of the agricultural produce goes to the owner of land, the tiller of the soil having to be content with a mere pittance, especially so on account of the smallness and uneconomic character of holdings. Certain enquiries made in the Punjab show that while the net income of the landlord averaged Rs. 30 per acre, under the above system, the tenant's net income from each acre was only 19 rupees.[2] And 56 per cent. of the holdings in the Punjab measure less than 5 acres, and this same state of things prevails almost generally in other Provinces, except Burma. Let us now turn to other features of the system.

Where a Jamindar, a Talukdar or a Malguzar has been recognized or created by government to stand between itself and the tiller of the land, the State takes a certain well-defined share of the rent received by that landlord from his tenants, say 40 to 50 per cent. Such a large share could be justified on the ground of State proprietorship of land and the achievement of land nationalization; but if it is a tax, it appears to be comparatively too heavy. In cases, as in Madras and in Bombay, where the State deals direct with the cultivators, it is supposed to step into the position of the landlord and to take a portion of the economic rent from them. If the government is not the landlord, its revenue is not rent, and this land tax of 50 or 60 per cent. and more,—at one time and in certain areas, it was avowedly as high as 70 per cent.—must have proved a crushing burden upon the agricultural industry and could not but have acted prejudicially on the condition of the people. What is more, the burden is liable to increase at every settlement because the State as landlord claims a share in the increasing net produce of the land. As a tax, government revenue may have to be enhanced according to its financial needs; but in that case the action of the State must be subject to the restrictions imposed by the laws of

1 Prof. Brij Narain : *Indian Economic Life.*

2 *Some Aspects of Batai Cultivation in the Lyallpur District of the Punjab,*—Board of Economic Inquiry, Punjab.

sound national finance. It is entirely due to the increased demand for India's staples abroad and in factories in this country and the high prices which have ruled in the market, that the ratio borne by the land revenue to the gross agricultural produce, has considerably declined and the resultant benefit has accrued to the landlord and the cultivator, subject to the deduction that must be made for the higher cost of production, which is a very important factor, often ignored or insufficiently attended to.

The history of the early stages of the development of the land policy of the British government shows how revolutionary changes in proprietorship and landed rights were introduced for securing administrative convenience and fiscal advantage and how Jamindars were created or recognized over the heads of peasant proprietors who had consequently to pay rents to overlords. The rents which would have remained in the hands of occupants of land were partly transferred to superior holders recognized by government. Many of the changes in proprietorship referred to above resulted from the political disturbances of the times preceding the advent of British rule, but several of them were the direct outcome of the British revenue system. By means of tenancy and other laws government has indeed attempted to repair its past mistakes. The bad effects have, however, been felt by the rayats for generations, and the State was itself moved to soften the rigour of its system. The latter fact is alone a sufficient condemnation of the system of land revenue under which the State presumes to take rent from cultivators in its capacity of universal landlard. The system has become out of date and must be radically altered. But so long as the principle of State land-lordism is there, animating the fiscal policy of government, mere palliatives will be of no use. In the matter of other industries, if a tax tends to fall on capital and to hamper their development, the State is called upon to and does refrain from imposing it. The agricultural industry, however,—the premier industry of the country—one which is admittedly in a deplorable condition, is exposed to a heavy tax which may amount to the whole economic rent or even may eat into the rayats' wages earned in that industry or by outside work. In his minute on Indian land revenue, Sir Louis Mallet remarked :—" On the one hand, we see a system which sweeps into the coffer of the State fifty per cent. or more of the net produce of the soil, thus diverting a fund which in countries where private property is absolute, would

to a great extent, find its way back again into channels of agricultural improvement. But the amount of the produce thus diverted is not only large—it is also uncertain."[1]

286. Wrong Theory:—Dr. Gilbert Slater and Mr. Anderson may be referred to here as two of the most recent and of the most emphatic exponents of the theory of land revenue being a rent in India. The latter's theory of land rent and its practical application to the system of land tenure and land revenue of Bombay,[2] have been criticised at length in the Appendix to this chapter and need no further discussion in this place. Suffice it to say that he upholds the Ricardian doctrine of rent in its extreme form, regards all land rent as an unearned income yielded by each acre of land and justifies its absorption by the State irrespectively of all other considerations. Dr. Slater maintains that the State is a part owner if not the full proprietor of all land except in cases where it has itself parted with its rights. Thus according to him, when the State takes Rs. 10 out of the Rs. 50 which a pattadar derives as economic rent, the State is really 'taking none of the income that belongs to the Pattadar, but instead, is allowing him to appropriate, in addition to the Rs. 25 which is the utmost to which he had any equitable claim, further income of Rs. 15 which by right belongs to the people of the country in their collective capacity.[3] We frankly recognize the legitimacy and the reasonableness of the State taxing the landlord or the cultivator like any other class of people for the benefit of the community; and what should be the incidence of the tax is a question open to discussion. But the claim of the State to share in the produce of land in its capacity as the landlord, can not be admitted, because that claim would entitle government to take the whole amount or any portion of the economic rent which rightfully belongs to the cultivator of land. Nor does the consideration that government takes a steadily decreasing proportion of the gross produce as revenue, prove any thing beyond the fact that it used to tax the rayat heavily and now feels the justice and the necessity of relieving the burden of the cultivator.

The old rulers did tax the land, but never set themselves up as the proprietors. Their demand might often encroach upon economic

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1 See Dutt's *Open Letters to Lord Curzon*, pages 184–185.

2 *Facts and Fallacies about the Bombay Land Revenue System.*

3 *Some South Indian Villages*, page 238.

rent and the system became oppressive when the collection of revenue was farmed out. Normally, however, they took a reasonable share of the produce and the tax was taken in kind. Even where as much as one-third was taken, it did not press heavily on account of the large size of holdings, greater productivity of the soil and the elasticity of the system of collection.[1] Metayage prevailed largely in India as it prevails in certain parts to-day, and was very advantageous to the cultivator. The government took as a tax a share of grain actually produced, and this tax varied according to the quantity of the yield. The commutation of the payment of corn into money payments and the rigidity of revenue collection, deprived the system of all elasticity and made the lot of the cultivator harder; and thus was it that a sympathetic and careful student of that system like James Caird, felt inclined to suggest the restoration of the old Metayer system. Taking the system, as it was, Mr. Caird also recommended the conversion of the rayat's tenure into a free-hold. He wrote:—"Whilst the majority of the Indian cultivators may indeed find it necessary to adhere to the Native principle of continuous tenancy a Government such as ours in India, should offer every facility for changing the tenure to freehold bacause it can be done without loss of revenue and when done and in the process of doing, that change would enlist the willing help of the most numerous and most industrious classes in improving the yield of the land and unite their interest with that of the rulers through whom their possessions would be assured."

287. Reform Needed :—A flourishing and contented peasantry is the backbone of a nation, and agriculture may be described, at least in India, as 'a key industry'; and it is necessary for the State to pursue a policy which will promote the economic well-being of the cultivating classes. It is for this reason that peasant proprietorship is favoured in all countries. That is also the reason why a moderate assessment of revenue, which will not be enhanced for a pretty long period, if not a permanent settlement of it, has been recommended to government.[2] If there is an outcry in England

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1 "A large cultivator may be able to bear tax burdens which would absolutely crush a small cultivator. The cultivator under Akbar paid the value of $\frac{1}{3}$rd of his gross produce as revenue, and still lived to cultivate the land."—Brij Narain: *Indian Economic Life*.

2 Dutt's "Open Letters to Lord Curzon."

against landlords and their unearned increment, the conditions there are quite different from those in India, and the policy of the British government in ameliorating the condition of the Irish tenantry is an example in point. The number of big Jamindars is growing smaller in India every day and landed property is being more evenly distributed. A majority of rent receivers are persons of limited means; and with several, rent from land is only a subordinate means of income. Investment in land is widely preferred in India, and rent is a partial means of livelihood with many. John Briggs writes:—"We have but one alternative, and that is to acknowledge, in the first place, the fallacy of that doctrine which assumes a right to take the whole surplus profit from the landlord, and to recognize the opposite maxim that the more which is left in his hands the greater will be his means to contribute to the national wealth, and consequently to the public revenue."[1]

But if the State does not, in its capacity of landlord, take rent from the rayat, some one else will, as rent must be paid for land. No. If the cultivator is the real proprietor, the Mirasdar,[2] as in the Deccan under the old rulers, he has no rent to pay, though he may pay a small land tax. In fact, there may be no rent accruing to many landholders, but merely bare wages from the cultivation of land and therefore no rent is payable. The bulk of the agriculturist's profits will, in any case, remain to fructify in his pocket. Is not the cultivator, however, extravagant and is it not better that the surplus produce should be taken by the State to be usefully spent on social improvements? We leave this argument to refute itself. It will take us into the realm of the theory of taxation but, at any rate, it knocks the bottom out of the theory of State landlordism. If the cultivator is extravagant, the artisan, the craftsman, the labourer, the capitalist, the official, are all equally so, and if in a general and equitable system

1 The Present Land Tax in India.

2 "The Mirasdar was the freeman of the village, his land was heritable and transferable and he held at a fixed assessment, though under the Mahratta Government he was liable to demands on account of extra cesses. In former times the name of the Mirasdar carried some degree of distinction with it, and the position was regarded as an enviable one......The most remarkable incident of the tenure was that it was nominally at any rate not subject to forfeiture for default of revenue payment or even for the abandonment of his village by the Mirasdar unless he was absent for a longer period than thirty years."-Selections from the Records of the Bombay Government, No. DXXIV—New Series.

of national taxation, the cultivator must pay a land tax at a certain rate let him be made to pay it by all means. But then do not regard him as a tenant or an occupant of government land paying rent to the State.

It is also urged that the value of land is steadily going up and that it is an indication that the burden of the land tax is not heavy. There is much subletting of land in the country, it is contended, and the under-tenants can afford to pay rent to the occupant of land and maintain themselves decently; land revenue is likewise paid without any difficulty—all which goes to show that the rayatwari and other Indian systems of tenure do not press on the agricultural classes. Land and rental values have indeed risen in many parts of the country, and the assessment to be paid to government is found to bear a smaller ratio to the rents paid to landlords, being from $\frac{1}{3}$ to $\frac{1}{5}$ [1]. The information given in settlement reports and collected in the course of village inquiries, shows how matters are improving in this regard; but the increased cost of production and the enhancement in revenue effected at each revision settlement rob the cultivator of the benefit resulting from high prices.[2] The competition of people who have no other means of subsistence and who have overcrowded the agricultural industry, is probably more responsible for this phenomenon than any thing else in many parts of the country while the higher prices fetched by land produce are an important factor elsewhere. The immobility of population, the social dignity which is associated with proprietorship of land and farming, the prevalent notion that land offers a superior security for investment, are also causes which are present in varying degrees in different places. The Indian cultivator, again, is not to be compared with the English or American farmer, who, armed with capital, carries on his industry on a large scale. The prevailing high prices during a few years certainly benefited several cultivators, and leaseholders have been paying higher rents to landlords. The 18d. ratio and the falling prices have now nullified the advantage.

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1 If the assessment is Rs. 2 per acre, the rent may be anything between Rs. 6 and 10, and the gross value of the produce per acre will be Rs. 15 to 25. The selling and letting values of land are connected with each other and with the value of the produce; but not necessarily so, other factors coming into operation.

2 Read the Broomfield Report on the Bardoli settlement for interesting information on this whole subject.

288. Protection of Tenants:—While, therefore, it is necessary that the theory of State-landlordism should be given up, peasant proprietorship should be encouraged and the land tax should be moderated so as to leave more in the hands of the cultivator, it is equally necessary that the interest of tenants and subtenants who pay rent to private landlords, should be adequately safeguarded. The State has a duty to perform as much towards the tenants of the Jamindars and other landlords whose rental it shares as towards the peasant proprietors, the rayats, whom it directly taxes. When Lord Cornwallis settled with the Bengal Jamindars and made the tax they had to pay permanent, he expected not only that the payment of State revenue would become secure, but also that the landlords would improve their estates and that the condition of the tenants under them would steadily become better.[1] But these expectations were not fulfilled and the state of the Bengal tenantry continued to be deplorable for two generations.

The land tax in Bengal was pitched sufficiently high, being nine-tenths of the rental, and as it was permanently fixed, was inelastic and was to be collected with the strictest punctuality, the tenants could not pay their dues to the landlords and the Jamindars could not meet their obligations to the State. The tenants had little protection afforded to them against the landlords' exactions and were harshly treated. Security of State revenue required that the Jamindars should be enabled to collect their rents from the tenants with ease; otherwise they would not be in a position to pay the land tax to government. Regulations passed in 1812 and 1822, gave little relief to the tenants; and an important duty of the State, which ought to have been discharged early in the last century and which practically formed a part of the general policy of the Permanent Settlement, was neglected. It was perhaps implied that the Jamindars were not to oppress their tenants and not to levy petty taxes on them in the shape of feudal dues. But in practice, little relief was secured to the tenants.

Tenants, all the world over, require protection against landlords, and it is extended to them in the form of fixity of tenure and

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1 "I should hope that the profits of the Jamindar would in time exceed this proportion (nine-tenths of the rental) by a due attention to the improvement of their lands and the encouragement of their Rayats."—John Shore.

fair rents. The demand for land is great and there are no non-agricultural occupations to which the rural population can turn. Consequently people can be found to take land on lease at high rates of rent. While the Government of India dealt with the Jamindars and took as its share a certain portion of the rental, it left them to collect whatever rents they could from their tenants. For a long time the status and rights of different kinds of tenants in the various Provinces had remained in a condition of uncertainty. Inquiries were, however, made, and in the course of the latter part of the last century, the position of the tenants was clearly defined and their rights were secured. This is a piece of work done by the State, the importance of which it is impossible to overestimate though it was tantamount to making amends for past injustice. As we have already pointed out, landlords' right had grown up in a variety of ways, and it was no easy task to determine the landlords' relations to the different kinds of occupants of land or tenants. A wave of im migrants or conquerors came into a province and reduced the landlords there, the descendants of the first settlers, to the position of tenants. The latter had rights, however, which were superior to those of the other cultivators who came later. Thus there were in Bengal the Talukdars and Tenure Holders who occupied a specially favourable position which had to be recognized; and the Khod-khast rayats or those who cultivated the lands in villages where they had long resided, were, therefore, given leases without any limitation of period as against the Pykost rayats or those who cultivated the land of villages where they did not permanently or long reside, and who held their lands upon a more indefinite tenure. Tenants at will stood on the lowest rung of the tenure ladder.

289. Tenancy Acts:—The transfer of the proprietorship of land by conquests, colonization, gift or usurpation, as it occurred time after time, constituted repeated social and agrarian revolutions in India. In a previous chapter we gave an account of the economic revolution which has taken place in the country; the radical changes in the ownership of land which took place at frequent intervals, were no less disturbing, as they related to the replacement of one set of proprietors by another. The rent which should have remained with the holders of land had, as a result, to be shared with the new proprietors. Similar phenomena in England at the time of the Norman Conquest and the Enclosure Acts may be profitably compared with

the Indian changes in land proprietorship. The Moslem, the Mahratta, the Sikh and the British conquests, not to refer to the earlier convulsions, created new problems of landlordship and tenancy by complicating the relations between proprietors and cultivators. It was in the year 1859 that the first modern Indian tenant law was made in Bengal, and in 1885 the Bengal Tenancy Act was passed, removing the defects of the earlier legislation and more elaborately securing the status and privileges of all classes of tenants. "The Act provides that every rayat who had held any land in a village for 12 years, acquires thereby a right. A small number of rayats hold at fixed rates of rent and the remainder are without right of occupancy. Even the latter, however, can not be ejected except in execution of the decree of a competent court, nor can their rents be enhanced at shorter intervals than five years. The Act was amended by Bengal Act I of 1907, with the object of giving greater facilities to landlords for the collection of rent and at the same time of guarding against enhancement of rent by collusive compromises, and removing the ambiguities, anomalies and defects brought to light by twenty years' experience of the working of the Act."

The Bengal Act of 1859 was extended to the North-Western Provinces, and it gave the right of occupancy to all tenants who had occupied their lands continuously for 12 years. The Agra Tenancy Act of 1901 provided that the change of a holding or dispossession for less than a year should not operate as a break in the period of twelve years. It also provided that a lease, unless it was for at least 7 years, could not bar the accrual of occupancy rights, the object being to induce landlords to grant their tenants long-term leases even if they did not wish that the tenants should acquire any rights. The rights of non-occupancy tenants also have been secured, and if their rents are enhanced, they are entitled to hold lands at those rents for at least five years. The recent tenancy legislation passed in the U. P. for Oudh, shows that the last word has not been said there and elsewhere, on the question of the laws relating to tenancy. It also demonstrates the divergence of interest between the two parties, the grievances of tenants regarding feudal dues imposed on them and the tendency of landlords to fight for their traditional and out-of-date privileges.

1 Decennial Report on the Moral and Material Condition of India, 1913.

The position of the tenant in the Central Provinces is much stronger than elsewhere. There the government determines, at each settlement, not only the amount payable to itself by the landlord, but the rent he is to receive from his tenants. The right of the "absolute occupancy" tenant is heritable and transferable, subject to pre-emption on the part of the landlord, and includes fixity of rent for the term of the settlement. The occupancy tenants have their rents fixed at settlement, which are liable to enhancement by a revenue officer at intervals of not less than ten years. The position of 'absolute occupancy' tenants is special and their rights can not be acquired, but the rights of the other class can be obtained by the payment of a premium of 7½ years' rental. By the Act of 1898 the rents of non-occupancy tenants have been fixed at settlement and exhorbitant rents are liable to be reduced, the right of transfer being withdrawn as in the case of occupancy tenants.

In the Punjab, half of the land is cultivated by peasant proprietors and some ten per cent. is held by tenants, who, on historical grounds, have been recognized as occupancy tenants with special rights and the remaining 40 per cent. is held by tenants-at-will. Occupancy tenants are protected by law from arbitrary ejectment and enhancement of rent. The other tenants may be ejected or have their rents enhanced; but if they are ejected, they can claim compensation for improvements made by them. By the Alienation of Land Act of 1900, the Punjab Government sought to remedy the evil of the passing away of lands into the hands of moneyed classes from the possession of the old agricultural tribes, by imposing restrictions on alienation. In the Jamindari areas of Madras, the rights of tenants have been secured by the Madras Estates Land Act of 1909 which repealed and reenacted the old Madras Rent Recovery Act of 1865. The main principle of the Act is that every cultivator admitted by the landholder to the cultivation of the estate lands has the status of an occupancy rayat who is protected against eviction so long as he continues to pay the prescribed rates of rent. Enhancement of rent is allowed only on certain clearly defined grounds and a non-occupancy tenant also may acquire occupancy rights under certain conditions. The tenancy law of the provinces of northern and central India has become so complicated and is being amended so frequently that it is not possible to give an adequate and up-to-date description of it here. Nor is that necessary

in as much as we are concerned more with general principles than with details of tenure systems and tenancy lgislation.

290. Bombay Tenures:—In the rayatwari tracts of Madras and in Bombay, the rayats are in reality, as we have shown above, proprietors of their lands, subject to the regular payment of the land tax to government. There are other tenures in the Bombay Presidency besides the 'rayatwari' or 'survey tenure', but they are confined to small areas and to a small section of the population. There is the Jahagir and the Inam tenure, under which government has alienated a part or whole of its claims to revenue. The right to collect and appropriate government revenue, constitutes the landlordship of the grantee whose descendants claim it as rent from the cultivators though the latter are owners of their lands. Grants of full or partial exemption of land revenue were made by former rulers as a reward for services done or to be done and to religious institutions. The old government imposed upon the grantees a quit rent in lieu of a variable land tax; and 'Jahagirs' and 'Inams' were granted in return for services to be rendered by the holders to the State. These have been continued on certain conditions and services have been commuted, in several cases, into money payments. The Talukdars of Gujarat are the descendants of old ruling families, and pay to the government, *Jama* which is either permanently fixed or liable to enhancement. There are also the *Giras*, *Vanta*, *Mehwasi*, *Narwadari* and *Bhagdari* tenures in Gujarat, under which the landholders pay to government either a quit rent or the usual assessment. These tenures have much in common with those prevailing in northern India and are to be traced to the same causes. The lands are held as shares of ancestral property; and rent is received and revenue is paid in proportion to the shares. The rents of some of the landlords e. g. *giras* were originally a blackmail, pure and simple.

The *Khots* of Ratnagiri and Kolaba districts, were settlers of villages and collectors of revenue, on whom proprietory rights came to be conferred. The class of cultivators called *Dharekaris*, who are the descendants of old settlers, are not their tenants, however, and only pay the survey assessment, thus occupying a privileged position. But other tenants have to pay to the Khots certain additional amounts, and the landlords are responsible for the collection and payment of the assessment into the government treasury. In

Ratnagiri this tenure is governed by a special Khoti Act of 1880, which has not, however, been extended to Kolaba as it should have been. The question of protecting the tenants of peasant proprietors or survey occupants in the Presidency, has been under the consideration of Government, as it is felt that the rights of these tenants also require safeguarding. Where tenure is hereditary, representing an old but lost claim to ownership, occupation or cultivation of land, the relations between landlords and tenants are complicated and feudal in character. Tenants-at-will or year to year tenants can not claim any privilege except what is allowed by the contract of tenancy. The position of such tenants is precarious and needs strengthening.

There is now a days a tendency among the tenants of private landlords to show a spirit of independence and to resist any extra demands of a feudal character made upon them by their landlords who never lose an opportunity to raise their rents. As elsewhere, there are good landlords and bad landlords in India, and the position of tenants will not improve, it is urged, unless their relations toward those whose lands they cultivate are strictly regulated by contract rather than by custom. The relations between the two parties have, therefore, become strained in several places and the tenants have declared strikes against landowners and refused to cultivate their fields. The inquiry into the condition of the tenants of indigo planters in Champaran in Bihar and the agrarian legislation it resulted in, revealed an astonishing state of things there. The *tin–khatia* system under which the planters compelled the tenants to grow indigo in certain selected portions of land, the low price which was paid for the produce, the exactions which were levied upon the cultivators under the names of *Sharabesi* and *tavan*, have all been condemned and the tenants have been emancipated from their condition of serfdom by the new law which was strenuously opposed by the indigo planters, a majority of whom were wealthy Europeans.

291. Redemption of Rent:—The provisions of the tenancy laws are calculated to make the cultivators feel a sense of security and freedom and to encourage them to pursue their calling with greater interest. These measures are, therefore, economically and socially most beneficial. In practice, however, they have complicated social relations and stimulated litigation. The landlords complain that their rights have been invaded and that the laws press severely

upon them. The tenants, on the other hand, ask for more freedom and protection. Here is an instance in which unfettered competition and free contracts are not left to determine the shares of owners and cultivators of land to adjust themselves, and the State interposes its authority in settling them. The ideal system of tenure is that which makes for efficient farming and creates a happy peasantry. The tenancy laws must be so framed and worked that friction between landlord and tenant will be minimised and not intensified. In England agricultural income is assessed to the income tax and the land tax is allowed to be redeemed, producing barely three quarters of a million at the present day. Certain important concessions and deductions have been allowed since 1896 with regard to the payment of the land tax. We should like to see this system introduced in India. Owners of land in the rayatwari provinces are proprietors of small pieces of land and cultivate them themselves. But the landlords of the higher castes do not and can not work on the land, and hire it out to petty tenants. It is difficult in such cases to determine who requires protection, the landlord or the tenant or both.

There is, likewise, an obligation upon the State to impose upon itself the same restrictions in its relations with the rayats and landlords whom it taxes, as are imposed upon landlords by the Tenancy Acts. It has, therefore, been suggested that the rayats should be allowed and assisted to redeem the obligation to pay an annual land tax, and to change the tenure to freehold property,—at least to lighten the burden of the land tax so long as this is not done. If land revenue is not a rent, as we contend, there is no question of the redemption of a rent charge by the payment of a capitalised amount. All income from land must be taxed subject to exemptions which are allowed under all good systems of taxation. Similarly with regard to private landlords, it has been suggested that the State should encourage and facilitate the redemption of rent and other charges paid by the rayats to the Jamindars and revenue-free tenure holders. This is the direction which agrarian reform should take if a prosperous, sturdy and contented peasantry is to be created out of the present thriftless and poverty-stricken mass of cultivators[1]. We shall refer to this question again in the Chapter on Taxation.

1 Read Ranade's "Prussian Land Legislation and the Bengal Tenancy Bill" in his Essays on Indian Economics. Read also relevant portions of the Report of the Taxation Inquiry Committee.

It is, however, doubted whether the ownership and cultivation of petty holdings in the hands of small men, is desirable, but the alternatives are landlordism and socialism.

It is sufficient to remark here that land should be held in such a way that the tenure will promote social well-being. The ultimate justification of private property in such a socially, economically and politically important form of wealth and instrument of wealth-production as land, must rest upon national utility. Even those who favour the nationalization of land and other factors of production have to concede the necessity of maintaining the private property of small, autonomous producers. The growing tendencies towards democracy in India will mean a weakening of the position of landlordism and capitalism. But it is not correct to say that land nationalization is already in existence in India and that this country is in advance in that respect of Great Britain, or that the interests of the country lie in regarding the land of cultivators as State property. The problem indeed is not easy. If land passes into the hands of non-cultivating classes, agriculture is likely to be neglected, but it will be equally neglected or will be inefficiently carried on if the cultivators are men without capital and enterprise. Land will, however, pass to those who save from those who do not and can not save, whatever measures the State may take to prevent this transfer. Lord Cornwallis, it was believed, brought English ideas into this country, unsuited to its peculiar conditions. It was thought proper that English landlords should be supported so that they might supply senators, sages and heroes to the nation. In India, however, it was stated, "we do not want generals, statesmen and legislators—we want industrious husbandmen." This was, of course, intended to apply to a conquered and not a self-governing India. The State has, however, to guard against the danger of having neither an opulent nobility nor a sturdy yeomanry. That is the problem to be faced.

292. Income from Land:—From statistics of occupations given on pages 150 to 152 in the first volume it will have been seen that in the whole of India, about 23 crores of persons are supported by ordinary cultivation and that of these about one crore derive an income from rent of agricultural land and $17\frac{1}{3}$ crores from ordinary cultivation. The number of actual workers who receive rents is 37 lakhs and of ordinary cultivators $7\frac{1}{2}$ crores; and this is exclusive of the agricultural labourers who receive wages for their work on

land. The number of landlords whose income is derived solely from rent for their lands, is, of course, small; and they constitute the privileged class of big Jamindars, Jahagirdars and Inamdars. Their number and incomes can be approximately ascertained from the revenue they pay to government, which is a certain percentage of the rents collected by them from their tenants. The rent roll of the Bengal Jamindars has gone up during the last century, according to one calculation, from 4 to 16 crores of rupees. There are about $2\frac{1}{2}$ crores of acres of land under cultivation in Bengal and slightly more than one crore of actual workers in cultivation, so that the rent works out at about $6\frac{1}{2}$ rupees per acre and 15 rupees per worker. Even in a province like Bengal, it is notorious that the Jamindari estates are being split up into fragments; and in several parts of the country the number of tenant cultivators is increasing. The payment of a large amount of land revenue is now the franchise for the election of members to the Indian legislative bodies, and it furnishes an index to the number of landlords whose rents are on a considerable scale.

Cultivating proprietors earn incomes which are made up partly of rent and partly of agricultural profit and wages. Such owners of land and claimants to rent are the majority in provinces and districts where there are no big Jamindars. Petty proprietors of land who belong to the trading, professional and other classes do not depend on rent for their livelihood; and in their cases, rent is only a part of their total income. They give their lands on lease to cultivators and receive rent in the form of grain or money. Rent is generally calculated at half the gross produce of land, and government revenue is paid either by the land-owner or the tenant in accordance with the terms of the agreement. The lease or patta or agreement is for a year or a period of years and is renewable. On account of the repeated and minute sub-division of land which has taken place all over the country, the average "landlord" in many parts of India is merely an exaggerated rayat or cultivator. The social status which the possession of land carries with it and the security of income which is associated with it, have rendered the position of a landlord attractive, but in the majority of cases, land is not a sufficient source of income, which has to be supplemented by income from other sources. The proportion of peasant proprietors and tenant-cultivators varies from district to district and so does the rate of rent, the latter depending upon the keenness of

demand for land and the productivity of the soil. "Taking all the Deccan districts together, there are 7,50,000 cultivating owners as compared to only 9,000 tenants. In Ahmednagar, the poorest of all the Deccan districts the percentage of tenants is conspicuously low. In this respect the cultivator's status in the Deccan compares favourably with the richer province of Gujarat (with Thana) where the number of tenant-cultivators is two-thirds of that of cultivating owners or with the Konkan where tenants are 4,00,000 to 1,60,000 cultivating owners."[1]

Rent is thus an element, in varying degrees in the incomes of people of almost all classes, traders, moneylenders, men in professions and craftsmen. Agricultural produce or money received in lieu of rent, goes some way to support the families of those who have land, and it is considered a great advantage to be able thus to secure the annual supply of food grains, in whole or in part, from lands owned. Half the produce of land, on an average, represents its rent, and the balance goes to the tenant as his wages and profit. Most of the owners of land of this description are inevitably absentee landlords, and high prices of agricultural produce and competition among the landless classes have recently pushed up their rents. Such landlords and their tenants or farmers have little in common with their brothers in other countries or with the big Jamindars and their tenantry in India itself. If the total land revenue of British India, including the amount 'alienated' is taken at Rs. 50 crores, and if the average rate of rent is assumed to be four to five times the assessment, the aggregate amount of rent received by owners of land will be Rs. 200 to 250 crores. This is about one-sixth to one-eighth of total national income of British India. This amount will be distributed among landholders in varying proportions. Hindu and Muslim laws of inheritance and repeated partitions of immovable property, have had the effect of reducing the productivity and value of the latter; and the incomes from these have consequently steadily declined. The general economic and social conditions are responsible for this state of things. The number of landlords with big rent-rolls is small, and though they are to be found in all Provinces, they are more or less restricted to certain areas. Values of land and rents have gone up in recent years, but in many tracts, landlords and lease-holders are so

1 Report of the Registrar of Co-operative Societies, Bombay, 1922-23.

mixed up that the true incidence of rent can not be easily found out. Thus in large parts of the Bombay Presidency, peasant proprietors whose holdings are small, will work these together with land taken on lease and the proportion of the two will be half and half. In such cases, rent will not look like an invidious share in the national dividend as it will appear when appropriated by the big Jamindars.

The land in the busy centres of cities and towns and in localities suitable for factories, has shown a tendency to yield increasingly high rents. Owing to political and economic causes, old urban areas are being deserted and the population drifts towards new centres of business activity. The growing demand for land for use as sites for residential and industrial or commercial purposes has raised rents, and many a lucky landlord has secured a windfall in unexpectedly high rents. Many of the old cities and towns with their congested, dark houses and narrow and dirty roads and lanes are being extended into the suburbs where the rents for sites for residential buildings are ten to twenty five times higher than they were a few years ago. It is superfluous to add that mining leases are a source of income to private owners of land and to the State and that the income is rent. Similar in nature is the income derived from the lease of forest land for the extraction of grasses and wood.

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APPENDIX

LAND-RENT AND LAND-TAX

A Lesson From Bardoli

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A good system of land revenue, particularly in the Rayotwari Provinces, must stand the test of correct economic theory in relation to value, rent and taxation, and it will be useful to examine the facts and the principles brought out by the Bardoli report, from this scientific point of view. Mr. Anderson[1] has presented his case with great ability, having brought to bear upon the work his unrivalled knowledge of the Bombay land revenue system and his vast experience of revenue settlements; and his book is enlivened with mordant wit and deadly sarcasm. But unfortunately his facts and his interpretation of them, have been rejected by competent, independent judges, and it will now be seen that his whole theoretical background is ill-conceived and ill-suited and that therefore, the entire picture is utterly distorted. In the preface to his book, Mr. Anderson says:—"The point urged that the whole facts are not available, is of course not true. All the relevant facts are fully available for those who will trouble to study them. But there are a great many futile and irrelevant enquiries which have never been made and ought not to be made. The salient feature of this Presidency is that there are far too many people on the land (not working on it, but idling) and far too few industries. Every step taken to reduce further the burden of the land tax must make conditions worse and worse, till a fearful disaster ensues. It is rent and land revenue alone that can save." The recent implicit admission of the Government of Bombay in the local legislature relating to the inadequacy of the facts in revenue matters as they are now available and their announcement about the provision they propose to make to collect more facts, to arrange them systematically and to maintain them up-to-date, is an interesting commentary on the opinion expressed by Mr. Anderson, but he will obviously reply that in this, as in other cases, "they have been guilty of unsound thinking." We have, however, to see here whether his theoretical discussion is sound.

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1 **"Facts and Fallacies about the Bombay Land Revenue System."**

It has been already indicated that Mr. Anderson is a thorough-going believer in Ricardo's doctrine of rent. Now, it is well-known that very few economists hold by the theory of land rent as it was conceived by Ricardo ; a large number accept it in a modified form and within severely narrow limits and several discard it altogether, all the while paying due tribute to its great author for the ingenuity and the scientific usefulness of his contribution to economic thought. Ricardo's theory of value has been almost universally discarded, and his theory of rent, which was indispensable to complete and to justify it, has gone by the board. Mr. Anderson thinks it superfluous to discuss the law of rent because he believes that "Ricardo has proved it to the hilt," and approvingly quotes Henry George thus:—"Thus rent, or land value, does not arise from the productiveness or utility of land. No matter what are its capabilities, land can yield no rent and have no value unless some one is willing to give labour or the results of labour for the privilege of using it, and what every one will thus give depends not upon the (absolute) capacity of the land but upon its (relative) capacity as compared with that of land that can be had for nothing." Then follows Mr. Anderson's commentary:—"Rent is that part of the yield or 'income' from land which is not earned, NOT EARNED either by the cultivator or the landowner, if there be one. . . . . Therefore it is rightly termed the 'unearned increment' (I prefer 'unearned income'), in other words, it is picked up like treasure trove, and every argument that starts with the idea that the rayat earns his land revenue and then has to hand it over to Government or a landlord starts falsely and ends worse."

It is not necessary here to trace the history of the development of the theory of rent from the time of the Physiocrats down to the present day, and it will suffice to say that while almost everything else in it has been rejected, the differential element in Ricardo's theory of land rent has been accepted by the majority of economists, and it has been extended and generalized. The most sympathetic writers, who are prepared to allow that Ricardo's theory was perhaps justifiable in the economic and social conditions that surrounded him and under the assumptions he made, categorically deny its validity as a general explanation of rent from land. As Prof. Buchanan[2] points out, Ricardo was "a remarkably able businessman who dealt with concrete national problems in a highly abstract manner," and the essence of his rent theory can be appreciated only if his hypotheses are clearly understood. Ricardo's theory of land rent was only a scaffolding for his labour or cost-of-production theory of value, and very naturally the former collapses when the latter falls. At the end of a sympathetic analysis of Ricardo's system of thought, Alfred Amon is thus driven to the conclusion: "So not one stone

2 In his article "The Historical Approach to Rent and Price Theory" in *Economica* for June, 1929.

of the superstructure of his economic thought remains on another."[3] The idea that rent is a surplus which represents the excess of the market price over different individual costs of production, has received general acceptance, but such a surplus does not, by any means, give an adequate explanation of the essence of the payment or income received by the landlord. Differential gain is not confined to the agricultural industry, and an element of rent can be traced in other incomes. This explanation has been developed in an interesting manner, among others, by Marshall. Why does land yield rent? Is it on account of its varied fertility or its scarcity or its niggardliness or the monopolistic character of its ownership? Any one of these explanations would, at best, be a half-truth. And Ricardo's theory may be regarded as such. The notion that land rent is an unearned income, originates even to-day in an unconscious and lingering belief in the labour theory of value. Rent is, again, said to be a social product, but which income is not a social product? Both wages and interest are social in this sense and value itself, is, in Economics, a social concept and a social phenomenon. Since there is, however, little difference of opinion among present-day economists as regards the differential element in land rent, the point need not be laboured here and we shall content ourselves with summing up the argument in the words of Prof. Rist:—"Rent, whatever form it takes, is not an anomaly, but a perfectly normal consequence of the general laws of value. Whenever any commodity, from whatever cause, acquires scarcity value—its price exceeds its cost of production, there results a rent for the seller of that product. Such is the general formula, and therein we have a law that is quite independent of the law of diminishing returns and of the unequal fertility of the land."[4] "Scarcity" is here to be understood in its technical, economic sense.

The statement that rent is not an element in the cost of production, which is true only when applied to the differential gains of intra-marginal producers, but can not be legitimately used with regard to all land rent as such, has caused a good deal of misunderstanding and confusion and is largely responsible for the conclusion that rent from land is an 'unearned income.' An essential condition of the Ricardian theory is the existence of no rent land. Land on the margin, where the price of the agricultural product is determined, has no supply price, and capital and labour shift from farming to manufactures and vice versa in order to secure maximum returns. According to Ricardo, there is only one margin for land, the non-economic margin, where land emerges from or lapses to nature, as labour and capital shift one way or the other, land itself having no alternative use and therefore earning no payment on the margin. In the article referred to above, Prof. Buchanan explains how the conclusion of Ricardo that rent does not enter into the cost of

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3 "Ricardo als Begrunder der theoretischen Nationalokonomie."

4 Gide and Rist: "History of Economic Thought."

production and the exceptions to this law, recognized by Adam Smith and Mill, proceed from two different sets of hypotheses. We shall quote from the article to clear up the position:—"The hypotheses of the Ricardian treatment were natural to the practical problem with which they dealt. They considered only rural rent and reduced all kinds of raw produce to one. They therefore supposed that land had only one use and that rent payment was not necessary to secure its contribution to the product. These hypotheses are essentially the same as those taken by the Physiocrats and by Smith when dealing with rent and "the produce of land." In all three cases the hypotheses depended upon the fact that the writers were interested primarily not in a theory of exchange for particular commodities, but in the incomes of the various classes." J. S. Mill found it necessary, in certain cases, to abandon the Ricardian position, to make rent an expense of production and to recognize that "there is a competing use for the land and that because it is valuable for one use that rental becomes a necessary expense for whatever commodity it furnishes."[5] Jevons went a step further, and "while Ricardo spoke of the shifting of labour and capital between raw produce and manufactures, Jevons adds the shifting of land between different kinds of produce, and insists that this is the rule. He is concerned not with the supply of "raw produce," but of potatoes, clover and turnips. And he takes for granted what the Ricardians did not, that the land has a competing use."[6] Jevons thus exposed a serious error in the thought of the "wrongheaded man" and his "wrong-headed admirer."[7]

Marshall made a notable contribution to the formulation of the modern theory, the theory of equilibrium of price and the competing factors of production, land included, at their margins of maximum utilization. While insisting on the fine distinction between return to land and to the other factors of production, he says:—"It is true that land is but a particular form of capital from the point of view of the individual manufacturer or cultivator. And land shares the influences of the laws of demand and substitution...because the existing stock of it like the existing stock of capital or of labour of any kind, tends to be shifted from one use to another till nothing could be gained for production by any other shifting......the income that is derived from a factory, a warehouse or a plough (allowance being made for wear and tear, &c.) is governed in the same way as is the income from land. In each case the income tends to equal the value of the marginal net product of the agent: in each case this is governed for the time by the total stock of the agent and the need that other agents have of its aid." In view of the ennunciation of this doctrine, Edgeworth thinks:—After this

5 Buchanan's Article in "Economica."
6 Buchanan.
7 "Theory of Political Economy" by Jevons.

explicit explanation it becomes a mere question of words whether we ought to retain the old formula "Rent does not enter into the cost of production." Professor Marshall retains it.[8] On account of the misapprehension which the time-honoured phrase caused, Marshall himself concluded: "it seems best therefore to avoid the phrase." Prof. Buchanan is not, however, satisfied with this incomplete or half-hearted exposition of the new theory, and contends that in spite of Marshall's recognition of the 'product-changing' margin in stating, for instance, that "each crop strives against others for the possession of the land, and if any one crop shows signs of being more remunerative than before relatively to others, the cultivators will devote more of their land and resources to it," he (Marshall) fails to state that "the whole produce from these places is marginal because of the shifting of the land." Marshall ignored the land-changing margin, and failed to show the whole machinery by which equilibrium is maintained.

A critic of the Ricardian doctrine puts it pithily when he complains that in it "by a sort of theoretical magic the entire prosperity of society is made dependent on land margins, instead of the general, mutually interdependent and shifting use margins of labour, land, capital and enterprise, covering the entire economic field."[9] He goes on to explain that there are margins of utilization in all parts of the economic field and every factor of production has its margin of utilization, and adds :—"The economic margin is a balance or a sort of equilibrium, although it may be a moving equilibrium. It is a place where applications of the requisites of production realize proportional returns under a system of competition, there being no surplus if all of the factors are on this margin." The difference between the old and the new theory is succinctly brought by Philippovich[10] in the following sentences :—"The new theory of land rent is distinguished from the old in this that the latter proceeded entirely from the phenomenon of a differential rent and did not regard rent as a price inasmuch as it considered rent as an effect of price. The new theory, on the other hand, explains land rent as well by the general law of price and believes that once rent makes its appearance, it enters into price, that differential rent is a phenomenon which is found likewise in connection with interest, wages and profit and there is, therefore nothing in it which is, special to land rent." Cassel[11] and Alfred Ammon[12] rest their theory of rent upon a similar foundation, which is relative scarcity. The latter observes :—"The value of no commodity would in reality, be determined by its own scarcity—that can well not be

8 "Papers Relating to Political Economy." Vols. I and III.

9 Richard T. Ely; "Costs and Income of Land Utilization."

10 "Grundriss der Politischen Oekonomie," Vol. I.

11 "Theoretische Sozialokonomie."

12 "Ricardo als Begrunder der theoretischen Nationolokonomie,"

because value indicates a relation—but the value of each commodity would be determined equally by the scarcity of other commodities." Criticising Ricardo's explanation regarding the emergence of rent on land of the second quality as soon as land of the next quality is brought under cultivation, he remarks :—" No! A rent emerges on land of the second quality the moment the demand for land of such a quality exceeds the supply of it, equally, whether land of the third quality is taken up for cultivation or not."

A slightly different but essentially similar explanation of land rent is given by thinkers who call rent an income from property.[13] Incomes are divided into labour incomes and property incomes, the latter being subdivided into ground-rent and capital rent. These are designated property rents to distinguish them from differential rents. It is not the differences in production costs which give rise to rent but the limited supply of available land as also the fact that land is private property. Thus we come to the idea of an 'absolute' land rent which is the price that has to be paid for the use of a productive good. Some economists, further, are inclined to regard land as a kind of capital and deal with land rent separately only on account of the circumstance that the supply of land can not be easily increased while that of capital goods is capable of increase without equal trouble. Socialists have seized the Ricardian doctrine and developed it into a monopoly and exploitation theory. Then again, it is impossible to separate Ricardo's 'original and indestructible powers of the soil' from what has been added to it by human labour. Instances are common, of lands which have been transformed by human labour and with the aid of capital. In a community where a large proportion of the people are small peasant proprietors, there is no question of exploitation by one class of other classes. It is in the interest of the community that its members should be provided with the means of earning a livelihood and at the same time be able to supply food and raw materials to society as a whole. It has been happily said that "land is the poor man's opportunity even though the returns are small in percentage"[14] and that investment in land is a kind of savings bank which forces people to save. It is notorious that returns from land are lower than in other investments. Competition for land is keen, as land is open to all and appeals to all.

To the Classical economists, land rent was a social surplus *par excellence*: only it was appropriated by one class to the detriment of the other classes in the community. This unearned income was consequently the most suitable source of taxation. Some modern thinkers who still adhere to the old view that rent is not an element in the cost of production, when called upon to ex-

13 Wolfgang Heller: "Theoretische Volkswirtschaftslehre."

14 R. T. Ely.

plain the apparent anomaly of land rent being included by individual landlords in their actual costs, declare that here payment of rent has been capitalized and the farmer expects to be reimbursed for the charge he has actcully to meet. But they go on to say that rent of land is not a cost from the social point of view, being a bounty of nature, though it is an individual expense, being a payment made for a costless facility or service received. Coulson,[15] for instance, says :—"From the social point of view, rent is not an element in the cost......The reason is that the charge does not correspond to any difficulty in production overcome by human labour, be it in the shape of immediate human labour or in the form of saving. It constitutes solely a payment made by one member of society to another for particular facilities provided by the latter." He hastens to add, however, that private property in land being an essential and beneficial social institution, it would be fatal robbery to deprive the landlord of the rent he has legitimately earned. This is an interesting illustration of the ingenious shifts to which thinkers are driven when they strive to adhere to an untenable theory. Mr. H. D. Henderson clears off the cobwebs woven round the subject and pointedly asks the question whether the money cost to the individual represented by land rent corresponds to and measures "any real cost to the community as a whole or whether it is, according to the old notion, a surpuls as something distinct from a necessary price." He answers the question unhesitatingly and correctly as follows :—"Land, greatly as it differs in many respects from the other agents of production, resembles them in the very important respects that, being used for one purpose, it is not available for other purposes, and that the productive powers of the community in other directions are thereby diminished. This is the real cost to the community, which attaches to the products of any industry, in virtue of the land it occupies, not any human labours or sacrifices required to produce the land itself, but the curtailment of the natural resources available for productive use elsewhere. This is the real cost of which rent is the money measure.........."[16]

Let us now return to Mr. Anderson and connect the correct theory of rent with the approved principles of taxation and examine the treatment this subject has received at his hands. He would obviously have hesitated to propose that by law the maxima rates of land revenue should be so fixed "as to take not less than half the rental value, as ascertained from actual sales and rent," if he had not been obsessed with the idea that land rent is unearned income—a treasure trove. It should be stated in fairness to Mr. Anderson that he allows total exemption from taxation to "the standard or ideal holding" in lands of different qualities and would tax only the surplus over this minimum. His theory of rent indeed requires this arrangement : all the

15 "Cours D' Economie Politique," Vol. I.
16 "Supply and Demand."

same, his main conclusion is not scientifically valid. He defines the standard work or holding as follows: "The standard work is that which is necessary to get a living off the poorest land actually in use. No one can possibly till poorer land: he must choose some other job. But the labour and other outlay needed to get that living will, if applied to better land, result in a surplus not earned or deserved." And again:—"......the just reward of agriculture is a fair living for as much work as it takes (in the circumstances of the age) to get that living off the poorest land in use taking as large an area of it as is needed for full work. On all other qualities of land, as much area as will give the same work is the standard or ideal holding. The better the land the equal dose of work yields a larger produce. But on all qualities for half work a half living is the just return, and so on. All surplus over this just reward is "rent." The decisive conclusion of Mr. Anderson from this which is of the greatest significance in the present discussion is that "rent is due and accrues on every square yard of land according to its quality—and independently of the number of persons seeking or claiming to live (without work) on that land." Does rent so accrue?

This argument proves how a harmless mathematical truth becomes a dangerous economic absurdity. A cooly receives 10 annas a day for working for 10 hours, which means, that on an average, he receives one anna per hour. But if he were actually to propose to work for one hour, he will not earn and receive that anna and may not be employed at all, being a nuisance rather than a help. A shop 10 ft. by 10 ft. fetches a monthly rent of Rs. 10, but a shop one-tenth that size will not fetch one rupee: it will not provide even sitting room. Every industry has a minimum unit of plant and buildings of its own; and size and quality must be given equal importance in organization if an economic activity is to yield a net return. In farming, as in other industries, rentability will depend upon the price level and the disposition of the different factors of production. In an ordinary farm, the peasant and the members of his family form the normal labour force, and their living wages constitute a standing charge, which, together with any interest that may have to be paid on working capital, will probably leave nothing as a net return to land. And in cases where the tenant cultivator has to pay contract rent to the landlord, this charge will cut into the wages of the cultivator's family and the deficit has to be made good by work outside or by borrowing. In an undersized farm, even if we calculate the wages for the actual period for which there is regular work in the field, nothing may be left over for rent of land. One of the peculiarities of agriculture is that the cultivator is rooted to his land, as it is a disadvantage with labour that the workman must go to the place where his services have to be offered. Mr. Anderson is quite right when he says that a landholder can not legitimately expect to receive 12 months' wages for 6 months' work, and thousands of our rural people do migrate to towns in search of work to supplement their earnings

from agriculture. With Mr. Anderson, however, all is mathematical calculation—Ricardian abstraction—and realities are irrelevant. He anticipates an objector and asks :—"If the true rent of a 20 acre full time holding is 100, how will it be possible for the man with only 2 acres of similar land to pay 10 ?" and proceeds to answer the question by saying :—" It means that he has ex phypothesi only work for 36½ days in a year (plus such extra work as is necessitated by the unsound and improper attempt to work the land in too small fragments) and from the gross produce he may deduct wages, &c., for those days and then he will find he has 10 left over for rent-revenue". Averages are necessary and good tools, but bad deceitful tyrants. Mr. Anderson seems to think that rent arises mechanically when land, men and implements are simply brought together, and the law of rent is like the law of gravitation. Men exist for the law and the law is not to be based on actual life. He says :—" But the small holder has no other occupation, he has learnt no other trade and there is no employer to give him work? If that is true, then the fault in the social structure is not in the law of rent but in the neglect to develop those other industries and that is the right direction of help and uplift." He has here placed his finger on the real weak spot and also in saying that there are, in the Bombay Presidency, far too many people on the land, and that this is a fault of the social structure. If this is so, how is the small cultivator responsible for the unemployment or underemployment which has been created by bad social conditions and how can he be taxed on a rent which actually does not exist but may come into existence under conceivably different social conditions ? Society can not first close other avenues of work and create overcrowding in agriculture and then come down upon the small cultivator, saying 'pay me out of your wages or out of the rent which you ought to and might have earned.' This is doing serious violence to the fundamental principles of taxation, if not also something worse.

Franz Oppenheimer,[17] who is keen on having big landed estates broken up into small plots for the use of peasant proprietors, vary properly finds fault with Ricardo (and this applies to Mr. Anderson, an admirer of his), for having developed only one side of the theory of rent, viz., the rent yielded by an acre of land, to the neglect of the others, viz., the size of the land holding. What he says in effect is this : Here is a small worker, engaged in market gardening in the vicinity of London and eking out a laborious subsistence on one acre of land. He is represented (by Ricardians) as favourably situated in an extraordinary way as to a differential gain because he has a fertile soil near a city, capable of yielding an enormous rent. And on the other hand, there is the Duchess of Sutherland who owns one lakh of acres of land of inferior quality in the Scottish Highlands, and is shown as seriously handicapped,

17 "Syetem der Soziologie"—Vol. III.

being unfavourably situated because she has land which is classed low on account of its quality and situation. Nevertheless, the former belongs to the wage-earning class and the latter is a big receiver of land rent! Philip povich[18] has likewise made this point clear, and he maintains that the emergence of rent does not depend merely upon the fertility and the location of land: rent has to be worked out by good technical and economic management and it is, therefore, closely bound up with incomes such as wages, interest, &c. It follows from what has been said above that whether land will yield a rent or net income, will depend upon the size of the holding, the quality and the situation of the land and the manner in which the agricultural operations are organized and managed. In the hands of a small cultivating proprietor, land will probably only provide means which are lacking to a landless man, for earning wages and nothing more, and the position of a tenant may be the same, perhaps worse, because he has to pay a contract rent. In holdings of a decent size, a net return will be available whether the land is cultivated by the owner or by a tenant. Only, the contract rent is no guide to the real rent-paying capacity of holdings in as much as allowance has to be made here for the risk of non-payment and the expenses of litigation to recover the stipulated amounts. In many cases, the rents contracted for are nothing but the amounts of interest on sums advanced by money-lenders who take leases from the cultivating owners. Agriculture is, in many cases, a supplementary or a parasitic industry, and there is no question of a surplus or a rent in it. The cultivator in such a case is a landed labourer.

Seligman's[19] brilliant criticism of the 'single tax' applies to Mr. Anderson's defence of the unearned income theory and a revenue system based on it, in so far as it is inspired by Ricardo's and Henry George's conceptions. That great American thinker has contributed, as few others have done, to the development and proper appreciation of the correct fundamental principles of taxation, viz., ability to pay and equality of sacrifice. The criticism of Mr. Anderson and the theory he upholds which we have offered in the course of this article, does not at all mean an attempt to bolster up the claims of any one class to light taxation or to exemption from public burdens. It is, by no means, incompatible, for instance, with the line of taxation-reform advocated in the excellent article, contributed to the last number of this Journal by Prof. J. C. Ghosh on 'Rent and Land Revenue in Bengal.' The land tax which now occupies a subordinate position in the fiscal systems of the leading countries of the world and is relegated, more or less, to local finance, is generally recognized as a real-tax or a tax on landed property, and as such, dissociated from all idea of the economic position of the taxpayer or his total taxable capacity. It is a tax upon land or rather upon its

18 "Grundriss," Vol. I.

19 "Essays in Taxation."

net produce. But though levied upon things, all taxes have to be paid by individual citizens and must come out of their incomes, land and buildings being taken only as indications of capacity to pay. The net income from land or the rental value, or in a few cases, the sale value, is everywhere usually taken as the basis of assessment and the necessary registers and records are compiled. The principle of land revenue recommended by the Taxation Enquiry Committee adopted by the authors of the Bardoli report is essentially similar to that underlying the systems of the land tax operating in the other countries of the world. Even a tax on things must satisfy the fundamental requirements of the principles of taxation viz., ability, equality and justice. The standard proposed by the Taxation Enquiry Committee, consisting in the net income of agriculture, which is exclusive of all costs, including return to enterprise, is quite reasonable; and equally reasonable is the percentage of this viz., 25 per cent which is proposed as the contribution to be levied by Government. The average 'annual value' must, however, be based upon actual realizations and not upon fancied and fanciful calculations. That was the trouble, as we have shown, in Bardoli, and is inherent in Mr. Anderson's manipulations of figures. For instance, he wonders why no complaint is made against the crop share rent system which does not ensure anything like a full living to the tenant, while fault is found with the Bombay revenue system for the same defect. He says :—"And yet no landlord, no inamdar or Talukdar, has ever denounced this root evil as inhering in that system. Yet if it lies in the Bombay l. r. system, then a fortiori, much more so, it lies in the crop share system which takes its share no matter how small the area held by the tenant." The explanation of this apparent anomaly is simple and is this: the landlord is the owner of his land and charges a price for allowing others to use it while the Government of Bombay is not the owner of the lands of the cultivators and can levy only a tax on incomes and not a rent or a price for the use of land.

A good system of taxation must take full account of the social and the economic condition of the people as it is and must be suited to it. If there are too many poor agriculturists in the community, that is not their own fault entirely, and you can only tax them according to their capacity. Government is not merely a tax-gatherer as Mr. Anderson seems to think, and must fully share the responsibility for the poverty of the cultivating classes and the industrial backwardness of the country generally. Mr. Anderson would tax the underemployed cultivators to make them work more and earn more. Why not suggest this admirable idea to the British cabinet who are confronted with a serious problem of unemployment? Tax the unemployed in Great Britain so that they will find work, instead of paying them doles as is now being done. There is indeed no charity in taxation, and every citizen must be made to pay, whatever his status, but there is the principle of justice, all the same, which must be honoured. The small holder does not cultivate his field for the sake of fun: he does his utmost in

the conditions in which he is placed. We do not propose to refer here to the aspect of taxation relating to Government expenditure, though it has a vital bearing upon the question discussed. Reference must, nevertheless, be made to Mr. Anderson's repeated complaint that the small landholder is being pampered at the cost of the potter, the blacksmith, the trader and so forth, when justice and equality are demanded for him. Now, what taxes do these good friends pay to Government? One is reminded here of Voltaire's story of "the man of forty crowns" related by Seligman.[20] Let us put it in the Indian garb. A cultivator who has paid a large part of his produce to Government as a tax, sees the money-lender who has grown fat on the interest wrung out of him, rolling along in a carriage and inquires what amount of tax he has paid. And the reply comes ringing: "I am no landed proprietor like you to pay taxes!" Neither penalization nor pampering, but justice and equalization of tax burdens according to capacity to pay and not the benefit received,—that is what is really needed. And there is no reason why an equitable basis for such distribution could not be found for general application and in the case of holders of agricultural land, in the net income as proposed by the Taxation Committee. The rental basis as worked out by Mr. Anderson, is bound to yield results which are miles away from reality and to prove unjust. Though it is claimed that the land tax is not an income tax, it often does work in practice like the latter. It was stated the other day on the floor of the Legislative Council of Bombay that though lands in certain tracts of the Presidency were admittedly inferior and the cultivators there were very poor, they could pay the land tax all right because they earned good wages in the Bombay mills! Let us have all relevant facts and let us scientifically interpret them. Let us not get round facts or juggle with them.

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20. "Essays in Taxation."

CHAPTER XVI.

WORKMEN AND WAGES.

293. Remuneration of Labour:—As rent is the remuneration of the landlord, wages are the remuneration of the labourer. In the last chapter we considered the economic position of the landlord, the income derived from land and the dependence of the condition of the cultivator on the system of land tenure; in this we have to point out the mutual relation of the system of industrial organization and the condition of workmen and the income the latter are able to secure from the product they help in creating. The cultivator or tenant, whether he owns his land or not, is a sort of an industrial manager if he manages the business of the farm and employs workmen on it and he may work along with the hands engaged by him. The net gain he can obtain is conditioned by the nature of the soil, the capital he can command and the tax he has to pay to government or rent to another landlord. If he works in the field he owns or takes on lease, or on the farm of another, the remuneration he obtains is the wage for his labour. The craftsman and the artisan have the same double capacity. They organize their business and combine individual labour with management and with the employment of hired workmen. Their earnings, therefore, contain an element of wages though they are their own masters and engage and supervise the labour of others. From the economic and social points of view, the question of wages is important because apart from the consideration of justice, there is the undeniable fact that on the condition of the wage-earner depends not only the efficiency of wealth-production but the well-being of the bulk of the population and therefore of the whole community.

In practice, it is often difficult accurately to distinguish the share appropriated to labour from those obtained by other factors of production. In agricultural and non-agricultural industries where the workman combines in himself the characters of organizer, labourer, landlord and also capitalist, the remuneration due to each one of

these agents, it is not easy to point out. But such a workman must receive at least the wages of his labour; otherwise, he will starve or give up his work. He may pay rent and interest to others but must secure a reward for his individual exertions. Under the modern system of industry, the autonomous workman who manages his own industry, has tended to disappear and a distinct class of labourers or wage-earners has arisen which does not control or share organization and management and which is severely confined to the job it is employed to execute. Though the position of workmen engaged in small-scale industries and establishments is often similar and sometimes worse, the intimate and sympathetic touch between employer and worker, which characterises this class of labour, is entirely absent in the large-scale industry. The factory system, under which the employer engages and controls hundreds or even thousands of workmen, has created a cleavage between the two, and the class conflict has become very acute. Those who command capital, command and control labour and their joint product, and it is felt by workmen that their share in the out-put of their collaboration is deliberately and selfishly kept low by the employer.

It is contended on the side of the employers that wages must be determined by the supply of and demand for labour; and that they can not be artificially raised or lowered. Strikes and labour agitation for higher wages, are, from this point of view, futile and suicidal. On the other hand, the wage-earners plead that employers take a disproportionately large share of the joint product and that they must be forced to give up their control of industry and their ill-gotten gains. Labourers, therefore, organize themselves, and by means of collective bargaining, which is substituted for individual bargains, so disadvantageous to workmen, extort higher remuneration and better conditions of work from the employers. The State has passed laws for their protection, and systematic attempts are made to decide disputes between capital and labour by conciliation and arbitration. In the contract between capital and labour, the latter is certainly at a disadvantage and hence the need of protecting and strengthening its position. Labour engaged in agriculture must be distinguished from factory labour as the conditions which characterise the two, are essentially different. But agricultural labourers deserve as much attention as factory workers.

294. Position in India:—The traditional position of those who work for others for obtaining a living, is one of dependence. Though the general principle that a workman is worthy of his hire has been accepted in India, as in other countries, prevailing sentiment and custom have played a conspicuous part in the determination of the wage of the labourer and the conditions of his work. The gradual emancipation of workmen from the position of slaves and serfs, demonstrates the economic and social evolution that has taken place all the world over; and their status in industrial organization has not yet been finally fixed. It is not, therefore, only the question of the amount of wages and the conditions of work in factories, that is at issue between employers and workmen. The latter are claiming a share in the management and control of industry, and the very wage system is being challenged. The socialists' demand for the nationalization of the instruments of production, means nothing less than a revolution in the existing economic organization, and the claim to fewer hours of work and higher wages is only a palliative that must serve only till the radical cure can be applied. The factory system, and the evils associated with it, gave rise to the labour movement and supplied the strongest incentive to and justification of the growth of socialism. The movement has now become international and a world movement; and India has been swept into its orbit by the political and economic unrest created by the war and the attention focussed upon the condition and rights of factory labour in this country. The international Labour Conferences have been and are being attended by representatives of Indian labour, capital and government; and with the growth of the factory system, western conditions are being reproduced here in respect of the struggle of workmen to attain their legitimate position. Representatives of factory labour have been appointed to legislative bodies to look after its interest, and the whole machinery of labour organization and labour legislation now common in the West, is being set up in this country.

The war gave a tremendous stimulus to the labour movement in this country; and capitalists and employers have already sounded a note of alarm. They maintain that much of the unrest and discontent prevailing among the working classes is due to the ignorance and the credulity of the operatives and the mischievous incitement of busybodies who do not care to realize the difficulties.

of the position in which they dabble. Such outside interference is certainly in evidence in several strikes of workmen, but in the existing circumstances it seems to be inevitable. As labour is organized and trained it will be able to take better care of itself. Such organization is proceeding apace and organized labour was not slow to convene an All-India Labour Conference and to ask that its representative on the International Conference and Permanent Labour Office should be elected by the workers themselves and should not be nominated by government. It is, of course, obvious that economic and social conditions in India are different from those prevailing in western countries and therefore the solutions of labour problems proposed by the international conference must be modified in their application to India. The draft convention drawn up at the Peace Conference recognized this fact and allowed for the differences in industrial, climatic and other conditions. Indian labour will, however, legitimately demand that, subject to this differentiation, it must have its rights recognized and that it must be accorded a fair and just treatment.[1] Under modern conditions and even in ordinary language, 'labour' generally means workers employed in big factories. But these do not exhaust the problem of labour in India as they still form a small proportion of the total wage-earning population of the country. That factory labour should engage so much public attention is natural; but it will be unfair and wrong to ignore the condition of other forms of labour in India. Labour in rural areas—engaged in agriculture, handicrafts and domestic work—is apt to be neglected because it is difficult to organize and can not find friends and champions. But in a country like India it must be paid as much attention as the labour in factories of the modern type and living in undesirable urban conditions.

1 "I need hardly say that the great diversity of physical conditions affecting employment in India, the lack of education among workers, and consequent low standard of comfort and absence of organization, the usually poor physique of Indian labour, and its inability to concentrate effort over shorter working period, the preponderating importance of agriculture and the lack of specialization and skill among industrial workers render it impossible to translate propositions which are accepted in western countries as natural into terms applicable to India or to devise any formula which will convert the Indian factors into Western equivalents......But while we recognize this we believe that there is a quickening consciousness throughout the country generally that the existing state of affairs is unsatisfactory and unworthy of India's political aspirations."—Lord Chelmsford's speech in the Supreme Legislative Council, 3rd September, 1919.

295. Chief Features of the Problem:—The remuneration received by labour in the form of money only partially represents its earnings and does not adequately reflect its position. In considering the problem of wages and of the general condition of workmen, we have to fix our attention upon (1) the numbers of different classes of workers, (2) the wage contract, (3) the rates of money and real wages obtained by workmen, (4) the factors which govern these rates, (5) the conditions in which labourers have to work, (6) the safeguards the State has provided for the fair treatment of workmen and measures taken for ensuring their safety, good housing and health, (7) organizations of workmen started and conducted to protect and promote the interests of members and to ameliorate their economic and social condition, (8) trade union movement, strikes, collective bargaining and the mutual relations of workers and employers, (9) the state of Indian industries in relation to the labour engaged in them and the question of unemployment, (10) the machinery necessary for settling disputes between employers and workmen e. g. for conciliation and arbitration and (11) the place ot Indian labour in international labour organization. Unless all these aspects are carefully studied, and placed in their proper perspective, it is impossible to obtain a correct idea of the condition of workmen and the measures which are necessary to improve it.

It used to be stated that the labour or wages question in India was not as urgent or difficult as it was in other countries, that the supply of labour was plentiful and cheap here and that the relations between employers and workmen, to put it negatively, were not unsatisfactory. What the statement was perhaps intended to convey was that the factory system had not yet established itself in this country to such an extent as to create a large, restless, discontented class of wage earners, crowded in cities and at the mercy of employers. The bulk of our workers are indeed autonomous producers, cultivators and handicraftsmen, and a very small proportion are mere receivers of a wage. Most of them live in villages and small towns, and their wages are, more or less, regulated by custom. The condition of all workmen who are hired for a wage without being allowed to participate in the profits and the control of industry, must obviously be unsatisfactory. It has not attracted much attention in India, because according to common belief, it was taken as a matter of course. Labourers were needy

and there was a plenty of them. Service was the hereditary occupation of many castes, and their members had no choice in entering into contracts with employers. Manual labour was not held in esteem and did not entitle the persons who hired themselves out, to claim better treatment than was normally accorded to them. Working under a master in isolation and in small numbers, they could not take counsel together and were forced to accept what terms were offered. It is, therefore, wrong to suppose that outside factories of large size and of the modern type there is no labour problem and that no relief is necessary except what is given by the Factory Act.

But this state of things is fast changing on acconnt of a general rise of prices, the extension of the means of communication, the increase in the number of factories and in the size of public works, the disintegration of village communities, the decay of old indigenous industries, a growing tendency towards migration, rapidly changing political conditions and the quickly spreading western influences. And the condition of factory workers in industrial centres and on plantations has not at all been satisfactory. Being ignorant and unoraganized, they and other labourers were, for a long time, docile and contented with their lot and little disposed to grumble and fight for their rights. This produced a false impression as to the general condition of Indian labour, which is now being rapidly dissipated. Labour conditions vary from province to province and industry to industry to such an extent that it is difficult and dangerous to generalise in this matter. But the condition of a factory labour is almost the same everywhere and there are many points which are common to particular classes of workers in the different parts of the country. An attempt will here be made only to indicate roughly the position of labour in relation to the points noted above.

296. Different Classes of Labour:—The reader should refer, in connection with the subject matter of this chapter, to the census statistics given on pages 150 to 152, of the number of persons engaged in various industries. It may be briefly recalled here that pasture and agriculture support nearly 23 crores of persons in the whole of India, that of these, 10½ crores are actual workers and that this last figure includes 3⅜ crores of women. Out of the above 10½ crores of workers, 7½ crores are ordinary cultivators

who may, however, work on their own lands, and therefore, be autonomous producers. The number of farm servants and field labourers, who are real wage earners as distinguished from the ordinary cultivators, is a little larger than 2 crores. It is difficult to separate pure labourers engaged in the non-agricultural economic activities except in the case of organized industries. The number of operatives employed in such industrial establishments having ten or more operatives engaged in each, was, according to the census of 1921, a little less than 27 lakhs. This number is exceedingly small when compared to 2½ crores, the total number of workers engaged in the exploitation of minerals and in the 'preparation and supply of material substances', the latter term including various industries and transport and trade. This shows that factory workers of the western type constitute only a small proportion of the total manufacturing labour supply of the country.

The above feature is a reflection of the present stage of the economic development of India. Autonomous workers and small-scale industries predominate in the country, and wage-earning hands are employed by the proprietors of petty concerns. There is a large floating population which does not possess special aptitude for any particular kind of work and this class of labour drifts from villages to the centres of industry in search of temporary employment. Most of this labour is, of course, unskilled and turns to domestic service or work on the plantations no less than to the docks, the railways and the factories. The ports and the cities draw to themselves unskilled men and women of this description and a number of skilled workers are likewise similarly attracted. In studying the condition of Indian labour, we must, therefore, distinguish several varieties of workers, and the fact that most of the operatives employed in factories, mines and workshops are predominantly rural in that they have homes, their bits of land and their families in the villages, must be borne in mind. Workmen engaged in urban factories and employees of railways and government departments, attract more attention because they are favourably circumstanced for organization and concerted action. It is true that the conditions in which these people live and work do require special consideration and remedies and that rural workers are much better off in several particulars. But it would be a mistake to suppose that the condition of farm labourers and workers in cottage

and 'home' industries is an ideal one. The fact is that many of these are in a worse plight.

297. Labour Contract:—A contract for the hire of labour between the master and the servant and between the industrial employer and the workman, has been recognized in India from ancient times by the usages and laws of the country and it was enforceable by the rulers. The injunctions of the old Hindu law-givers which crystalised prevalent customs, are clear on the question of the agreements relating to wages; and employers and labourers not performing their part of the agreements are made liable to fines.[1] The reciprocal rights and liabilities of employers and labourers are elaborately stated by Chanakya in his Arthashastra which also shows that slavery was a well-recognized institution in that period. Slaves appear to have been common from remote times as references to them in the ancient literature show, and were employed to do dirty work. Slavery has long disappeared but a system which is akin to serfdom is to be found in several rural areas. The condition of such labourers is deplorable and they serve their employers on a mere pittance. One also comes across forced labour or *begar* and *vetha* in the case of lower classes of workers[2]. Tenants and others who are under the influence of big Jamindars are made to work in this way. The condition of the depressed classes who are restricted to certain species of work and to limited remuneration, is most unsatisfactory. This old feudal system is, however, disappearing and the development of society from status to contract, is in operation.[3] Village economy has been disorganized

1 See Narada, V and VI.

2 "If a poor man required Rs. 100 to enable him to get married or to clear himself from debt, he would mortgage his service for a period of about five years and receive his Rs. 100 in advance; while the mortgagee was bound to feed him during the period of service. Many of the Deshmukhs, Deshpandes and rich landholders engaged labour in this way: and the practice continued in some degree to quite recent times. In the days when land was available for all, however, it would have been only the very poorest who would mortgage their labour in this way, or even engage themselves as yearly tenants."—Keatinge: Rural Economy in the Bombay Deccan, page 67.

3 The Government of Bombay, for example, state in their Resolution on the Land Revenue Administration Report for 1908-09, that "in the Surat District, the Anavala Brahmin is losing the services of his halis or hereditary serfs, and everywhere customary tasks at customary wages are giving way to full contracts."

and the customary relations of different classes and castes towards one another, are changing. The *vatan* system under which the work and wages were permanently fixed and hereditarily accepted, has gone to pieces, and it is admitted that it was not a system that made for efficiency or harmony. The practice of unpaid, customary labour is dying out, and the urban and modern system is slowly taking its place. The rural labourer is still too helpless, ignorant and backward to stand on his own legs and insist upon a fair wage contract. He is often indebted to his employer, and this means perpetual dependence and hereditary serfdom. This system is but too common in the interior of the country, and it will take long before it is radically changed.

An attitude of independence on the part of labour is everywhere visible and particularly in cities and in centres of commerce and industry. Labourers have become conscious of their importance and of their place in industrial economy, and the growing demand for their services has largely contributed to this result. Domestic servants and unskilled labourers show this tendency as much as factory workers and artisans. A sort of a wage-earners' contract is becoming common, and the workers insist upon its terms being strictly observed by the employers. Factory Acts have laid down certain conditions of work and imposed obligations on the employers, and workmen have realised that they have rights on which they can take their stand. Another factor that must be borne in mind in this connection, is the continuity or otherwise of employment. When the labourer is bound by contract, he has the advantage of continuous employment, though his wages may be low and his freedom may be curtailed. Agricultural labourers and workmen engaged in industries which operate only during certain seasons, like ginning for instance, are thrown out of employment at the end of the season. Work on land is seasonal; the sowing and the harvesting seasons provide ample employment to men, women and children in the rural areas, and their earnings at that time are good. The living of most unskilled labourers is, therefore, precarious and they turn from one job to another and suffer when there is no work to do. Higher rates of wages must compensate them for this occasional loss of employment; or a variety of remunerative work must be made available.

298. Indenture System:—The system of indentured labour under which 'coolies' emigrated from India to the Colonies in large

numbers, has been strongly condemned as degrading and demoralising and is now extinct. Indentured emigration to Natal was stopped in 1911, the Emigration Act of 1908 having been suitably amended in 1910 for the purpose at the instance of the late Mr. Gokhale, who two years later, moved another resolution in the Supreme Legislative Council, recommending that government should "take the necessary steps to prohibit the recruitment of Indian labourers under contract of indenture whether for employment at home or in any British Colony."[1] Objection having been taken to his comparison between the system of indenture and slavery, Mr. Gokhale replied:—"It is true that the system is not actual slavery, but it is also true it is not far from it. The contract is not a free contract. You have here the right of private arrest, just as they had in the case of slavery. Moreover, the labourer is bound to his employer for five years and he can not withdraw from the contract during that period. And there are those harsh punishments for trivial faults. Therefore, though the system can not be called actual slavery, it is really not far removed from it."

A strong case was made out against indentured emigration to Colonies like Trinidad, British Guiana, Jamaica and Fiji, and as a temporary war measure it was stopped early in 1917. Indentured emigration to these colonies has now practically ceased. The total number of coolies emigrating under the Indian Emigration Acts, from the Indian ports, was 15,117 in 1907-08, 12,658 in 1913-14 and 7,556 in 1915-16. The number dwindled to 221 in 1919-20 and was 1184 in 1920-21. It has again risen within recent years, being 1,46,201 in 1923-24 and 1,34,893 in 1924-25. The bulk of these emigrants, however, go to Ceylon and the Straits. The number of emigrants returning to India was annually six thousand on the average for the six years, 1911 to 1918. The figure for 1920-21 was 11,575. Owing to the treatment received by Indian workers and others abroad, emigration has become very unpopular in this country and the tempting offers made by some colonies have not induced a favourable response. The question of labour emigration has been under discussion for the past few years. The interests of the employers in the Colonies have all along stood in the way, and all arguments in favour of the system, such as the economic benefit derived by the labourers, were proved to be unsubstantial in

1 See Mr. Gokhale's Speeches, pages 604-643.

a despatch sent by Lord Hardinge's government on that subject to the Secretary of State. In a despatch to the Government of India, dated September, 1917, the Secretary of State for India remarked:— "I agree with Your Excellency's Government that any new system of emigration must be free from the suspicion of liability to the charges brought against the old system that it was based on fraudulent recruitment; that it involved slavery for men and that it resulted in the prostitution of women."

The question was considered by a Inter-Departmental Conference in London and a new scheme for a system of free emigration assisted by the Colonial administrations was evolved. It is stated that under the new scheme, while all the advantages of the old system are retained and even improved, the emigrant labourer will not be bound to any employer except for the first six months of his stay in the colony. The difficulty of solving the problem lies in ensuring complete liberty to the labourer, and at the same time, in giving him effective protection against fraud or ill-treatment. Under a free contract, it is pointed out, the position of the emigrant is likely to be worse and all emigration to the Colonies will have to be prohibited. In any case, there must be no return to the indenture system under a new name and government must firmly adhere to the principle that it is not the business of India to supply coolies for the exploitation of the resources of the colonies. With the labour upheaval which has burst out in India, serfdom in the form of indentured labour is no longer possible.

For several years an indentured labour system prevailed in India itself. e. g. in Assam, where planters imported coolies for their gardens from the neighbouring provinces. For more than sixty years, "questions relating to the supply of labour for the tea industry in Assam, the condition of the labourers on the estates and the enactment and working of special labour laws, have attracted much attention and have formed the subject of several detailed investigations by specially appointed committees". The law in this matter was amended and consolidated by the Assam Labour and Emigration Act of 1901. This Act too was amended in 1908, and a steadily increasing proportion of the immigrant labour was engaged under ordinary contract, Government having gradually withdrawn successive districts in Assam from the operation of the Act of 1901, which authorised an indenture system. The Assam system had

two salient features: penal contract with the labourer enforceable through the criminal courts and provisions for the protection of the labourer. Coolies were recruited through (1) contractors and (2) garden *Sardars*, persons employed by the planters. Indentured labour has now ceased altogether and recruitment by contractors, which led to many abuses, has been abolished. Labour in Assam is now free, though recruitment is regulated by law and is now controlled by a special Board consisting of representatives of the planters and an officer of government.

299. Pre-War Rise in Wages:—During a few years preceding the War, wages of all kinds of labour rose. The statistics available on this point, are indeed not very accurate and can not, therefore, be relied on. We have also to take note of the circumstances which accompany the money wage in order to find out 'real' wages. From every Province, however, came the report that there was a general rise in wages in the first decade of this century. In Madras, for instance, "the wages of unskilled labour have everywhere shown a marked tendency to rise...Domestic wages have certainly risen, and Government servants on low pay have for several years past, been granted grain compensation allowances...The monthly rates of wages for farm servants, however, followed the general rise. Wages of artisans also rose." In Burma, "during the ten years (1901–10) the translation from a natural to a money economy has made further progress. Most agricultural-labour, however, is still paid in kind, and the field labourer's wages as measured in money have therefore risen in Lower Burma. In Upper Burma also agricultural wages tend to rise, owing to the increased annual exodus of field labourers to Lower Burma." "In the Punjab, cash wages are steadily displacing old customary wages in kind, the process being in many parts already complete. At the same time wages of unskilled labourers and of skilled artisans have doubled in the past twenty years, the greater portion of the advance having taken place in the last ten years, and in particular since 1905. This increase represents an increase in real wages though not of the same extent as the rupee equivalent, and marks the operation of the law of supply and demand emancipated from the dead hand of custom." [1] These instances are typical of what was happening all over the country.

1 Decennial Moral and Material Progress Report, 1913.

Mr. K. L. Datta has compiled the following table showing nominal and real wages :—

	I—Nominal wages.				
	1895	1900	1905	1910	1912
RURAL.					
Agricultural labourers ...	105	125	147	170	189
Village artisans ...	107	127	149	173	191
Average ...	106	126	148	171	190
URBAN.					
Skilled labourers ...	106	122	143	167	183
Unskilled „ ...	108	127	151	177	198
Domestic servants ...	104	117	131	147	159
Average ...	106	123	142	165	181
CITIES.					
Skilled labourers ...	105	122	142	167	177
Unskilled „ ...	104	123	140	167	179
Domestic servants ...	102	118	134	149	159
Average ...	104	122	139	63	174

	II—Real wages.				
	1895 to 1899	1900 to 1904	1905 to 1909	1910	1912
RURAL.					
Agricultural labourers ...	103	120	123	134	138
Village artisans ...	105	122	124	135	138
Average ...	104	121	123	135	138
URBAN.					
Skilled labourers ...	104	119	120	132	134
Unskilled „ ...	106	122	125	135	145
Domestic servants ...	100	116	108	117	116
Average ...	108	118	119	181	133
CITIES.					
Skilled labourers ...	105	181	120	131	130
Unskilled „ ...	104	117	120	131	132
Domestic servants ...	102	113	111	111	116
Average ...	105	117	118	129	128

If different industries are taken, it will be found that the rise in wages was not uniform. It is curious to notice that 'the coolies in tea gardens appear to be in the worst position, as their *real* wages have fallen 5 per cent. below those in the basic period,' though it is pointed out that these labourers get rice at a fixed rate, generally lower than the market rate. The comparative lowness of the wage on the tea gardens struck the committee which inquired into the question of Assam labour in 1906. The Director of Statistics observes.—" It is interesting to note that the rise in the wages of industrial labour has not been so great as in the case of agricultural labourers and village artisans. Money wages have over long periods increased in all industries, and the rise has generally been greater than or equal to the rise in retail prices except in the tea, sugar and brewing industries. An examination of Indian wage statistics during the last decade shows that this is certainly the labourer's day." [1]

The rise in wages can, of course, be beneficial to labourers only when the prices of their necessaries of life have not gone up in proportion or the general purchasing power of the money wages has increased. If the field labourer is paid in kind and food grains become dearer, he obviously benefits; but if he has to purchase food with his money wages, the increase in wages must be greater than the rise in prices. The factory labourer may have to pay more for rent, food and clothing and he may be none the better for enhanced wages. 'In Bengal,' we are told, 'the labouring classes were not much affected by high level of prices. The great majority are field labourers, who are mostly paid in kind. Their wages remain the same, but the value of grain has risen. When they are paid in cash, their wages have increased, notably in Bengal, where the supply of labour is frequently short of the demand.' Many factors have to be taken into calculation, therefore, in estimating the effect of higher money wages upon the condition of labour.

300. War and Wages:—A period of high prices is a time when employers' demand for labour is exceptionally keen and they can afford to pay high wages. There is generally a lag, however, in the rise of wages and when once they do rise, it is not easy to reduce them because workmen are seen to have adopted a higher standard of living. An unprecedented increase in wages was one of the effects of war conditions combined with the famine and the

1 Review of the Trade of India in 1913-14.

influenza epidemic of 1918. The demand for labour was large during war time and prices of the necessaries of life were steadily rising. The cost of living reached a level at which it threatened to stand permanently. At any rate, each class of labour found it impossible to support life on the prevailing rates of wages. The index numbers computed on the rates of wages earned in different industries during January of each year from 1915 to 1918, as compared with the pre-war period are given below :—

Movement of Industrial Wages.

Industries		1914	1915	1916	1917	1918
Cotton, Bombay	...	100	103	103	106	129
Wool, Cawnpur	...	100	112	108	117	118
Mining (coal) Bengal	...	100	100	100	108	116
Tea, Assam	...	100	102	103	109	119
Brewing, Punjab	...	100	101	109	121	130
Jute, Bengal	...	100	101	100	101	103
Paper, Bengal	...	100	99	99	99	100
Rice, Rangoon	...	100	100	100	100	100

The following table shows the percentage increase in rural wages of three classes of rural labour in the Bombay Presidency for 1922 over 1900 and 1913 :—

Percentage increase in wages in 1922 over

	1900 (the base year)			1913 (the pre-war year)		
	Field labour	Ordinary labour	Skilled labour	Field labour	Ordinary labour	Skilled labour
Divisions—						
Northern Div.	256	300	272	113	135	153
Central ,,	189	150	94	53	39	43
Southern ,,	189	175	150	63	74	67
Economic circles						
Gujarat ...	256	311	307	113	131	151
Deccan ..	178	160	111	56	44	48
Konkan ...	206	209	130	89	102	102
Presidency Proper ...	211	210	167	75	72	86

The following table shows the average monthly earnings of men, women, big lads and children and of all work people working full time in the cotton mills in the Bombay Presidency in the years 1914 and 1921 :—

Centre	Work people	Monthly earnings per head						Increase per cent in 1921 over 1914
		1914 May			1921 May			
		Rs.	as.	p.	Rs.	as.	p.	
Bombay (City and Island)	Men ...	18	6	8	34	15	2	90
	Women ...	10	0	10	17	6	6	73
	Big lads & children	9	6	7	18	0	10	92
	All workers ...	10	6	3	30	10	0	87

Centre	Work people	Monthly earnings per head						Increase per cent. in 1921 over 1914
		1914 May			1921 May			
Ahmedabad ...	Men ...	15	7	1	34	2	11	121
	Women ...	9	15	11	19	9	4	96
	Big lads & children	7	2	3	18	6	6	158
	All work-people...	13	9	9	30	2	11	122
Sholapur	Men ...	14	3	11	25	13	9	82
	Women ...	5	13	11	10	15	9	87
	Big lads & children	6	9	6	14	12	0	124
	All workers ...	10	9	4	20	9	4	94
Presidency	Men ..	17	0	8	33	6	10	96
	Women ...	9	0	1	16	9	1	84
	Big lads & children	7	13	4	17	3	7	119
	All workers ...	14	11	11	28	14	4	96

The famine which prevailed over large parts of the country in 1918 and the continued scarcity and high prices of certain necessaries of life, caused a demand for increase in wages everywhere. There were numerous strikes all over the country for a rise in wages and the demand had to be conceded. There was a

sharp rise in wages, therefore, in all industries after 1918 and a high level was reached in 1920-21. The wages of domestic servants and of agricultural labour had to be increased all round, and the salaries of government and private servants had to be considerably advanced. The successful labour strikes of the time for wages show how workmen were driven by the intolerably high cost of living to prefer a demand for an increase and how employers could not refuse to comply with it.

In England, wages rose enormously during the War along with the cost of living; and with the steady decline of the latter, proportionate cuts have now been effected in wages. This readjustment has been the result of friction and mutual agreement between employers and employees. There has been no standardised wage in different industries or in any individual industry in this country and no fixed standard of living for the factory workers. But the operatives in the Bombay cotton mills resisted a cut in wages proposed by the owners in 1925 when the industry was in a bad condition. The importance of standardisation has now been appreciated, and the Bombay "Labour office" compiles and publishes cost of living and wage statistics regularly so as to help factory owners and operatives in following the movement of prices and labour earnings. This subject is further dealt with in a later section of this chapter.

301. Causes of the Rise:—The relation of demand and supply is, of course, a great regulator of prices and among them, of the prices of labour. Workmen of a particular class may be in greater demand at a time and naturally their wages must go up. The gradual expansion of commerce and the development of industry, characteristic of the last thirty years, are certainly one of the causes of the steady rise in wages in India, and it is intensified, in certain areas and as regards certain industries, by the immobility of labour, and therefore, by a lack of competition. Take it or leave it, seems to employers to be the motto with labour of particular classes and grades. The available supply has also diminished owing to deaths due to epidemics like the plague, which alone has carried off over a crore of people since its advent into this country. And the havoc made by influenza in 1918 told visibly upon the supply of labour. High mortality among labourers thinned their ranks and it seems to have been an important factor in the situation.[1] Conditons with regard

1 This subject has been already dealt with in Chapter V.

to the supply of labour of different classes, in the pre-war, war and post-war periods, will be instructive to compare. In war-time demand for all kinds of labour was naturally very keen, and in the times of depression which followed, unemployment became a serious evil, except for skilled and specialised workers.

A general rise in prices is another cause of the increase in the scale of wages. Economists have discussed various theories concerning wages, such as the cost of production theory, the wages fund theory, the standard of living theory and the productivity theory of wages. None of these theories can be accepted as satisfactory by itself, though each one of them contains some truth, and they are all complementary to one another. Wages will rise if the wealth produced by a community increases owing to greater efficiency of labour and of organization and to the application of more capital. But increased out-put of wealth is a condition and not a direct cause of the rise of wages, and the workmen must be sufficiently organized and intelligent to be able to secure their proper share of the increase. Similarly, workmen come to have a certain standard of life which steadily improves and necessitates the payment of a higher wage. Higher prices and increasing wants regulate the remuneration workmen must receive, if they are not tied down by custom. Generally wages lag behind prices and gradually overtake them as a result of economic friction. This is what happened to factory workers just about the close of the war period, and also to government and private employees in India. Take, for instance, the case of an unskilled labourer in a city like Poona. The normal daily wage of a male labourer forty years ago was four annas. But at that time, Bajri used to sell at 16 seers and rice at 10 seers a rupee; house rent was low, vegetable oil sold at 4 seers per rupee, fuel at 8 annas per maund, and a dhoti cost from 8 annas to $1\frac{1}{2}$ rupees; and, on the whole, necessaries of life were cheap. Now the labourer seldom gets 5 seers of Bajri, 4 seers of rice and $1\frac{1}{4}$ seer of oil per rupee; fuel, rent and cloth have all risen by nearly more than 200 per cent.; and it is no wonder if he demands 10 to 12 annas a day as his wage. Indian labour is now, besides, being better organized and is becoming more intelligent, especially in large industrial centres, and its demand for higher wages in response to dearer living, can no longer be ignored. In Bombay, Ahmedabad, Madras, Calcutta and many other places the strike weapon has been

successfully used to extort higher wages. In times of prosperity, employers are compelled and consent to pay higher wages as high prices necessitate and allow of the rise. It is in times of depression that difficulty arises.

302. Real Wages:—In view of the steady rise in prices after 1918 and the slow decline after 1922, it is necessary to ascertain the trend of the 'real' wages of labour and this can be done by comparing the levels of prices and money wages over a series of years. The mere fact that wages expressed in terms of money have risen, is no index to the level of workmen's living as the increase may be offset by the dearness of the necessaries of life. And again, while wages may be higher comparatively, they may be low absolutely. Let us first examine the movement of prices and wages in the pre-war year and the post-war period. The following table gives the index numbers for the prices of the chief food grains in important centres for the year 1921 as compared to those for 1913:—

Retail Prices in 1921.

(Prices in 1913=100.)

	Rice	Wheat	Jawar	Arhar Dal	Salt
Calcutta Port	133	...	...	190	192
Bombay „	140	173	191	206	123
Madras „	143	...	...	...	153
Bengal Presidency	126	...	...	203	160
Bombay „	149	201	216	202	137
Madras „	133	...	167	...	131
U. P.	156	195	210	209	149
Punjab	172	218	273	237	181
C. P.	165	216	210	209	132

The following is the position in Assam, Calcutta and the United Provinces with respect to average wages :—

Average Monthly wages on Assam Tea Plantations.

(Non-Act Coolies).

	1913–14	1917–18	1918–19	1920-21
	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.
Men	6 1 3	6 4 3	6 5 9	7 0 9
Women	4 11 5	5 1 2	5 1 5	5 12 7
Children	2 13 7	2 13 5	3 1 5	3 7 10

Wages in Calcutta Jute Mills (Per Week).

	1914	1921	1922
	Rs.	Rs.	Rs.
Spinners	3·45	5	5
Weavers	5·6	9·2	9·2

Index Numbers of Average daily wages in an Engineering Workshop in the U. P.

(Rates for 1873=100).

		1900	1910	1915	1918	1921	1922
Skilled Labour	...	94	116	148	145	194	200
Unskilled ,,	...	107	167	147	173	280	293

Variations in the nominal and the real wages in Bombay are shown in the following statement :—

Index Numbers showing increase in the cost of living and nominal and real wages in Bombay in April, 1922.

(1914=100)

	Cost of living	Nominal Wages	Real Wages
MEN			
Mill Operatives:—			
Time workers	162	189	117
Piece ,,	162	174	108
Power House and Maintenance Staff	162	183	113
Miscellaneous			
Stores and Godowns	162	166	103
Ramoshis	162	204	126
Mill Clerks	162	192	119
Women			
Time Workers	162	159	99
Piece ,,	162	169	105
Mill Sweepers	162	187	116
Boys and Children			
Full time	162	180	112
Half ,,	162	185	115

Real Wages in Rural Areas in Bombay Presidency.[1]

	Cost of living Index Nos.	Index Nos. of nominal wages			Index Nos. of real wages		
		Field labour	Ordinary labour	Skilled labour	Field labour	Ordinary labour	Skilled lab ur
	1910=100						
1914	117	180	183	133	154	156	114
1921	195	270	258	217	138	132	111
1922	200	290	283	233	145	142	117

1 See Report on an Enquiry into Agricultural Wages in the Bombay Presidency, published by the Bombay Labour Office.

303. Standard of Living:—Speaking generally, the effectiveness of the labourer's income depends not only upon the purchasing power of the money wage, but also the advantages the workman enjoys as additional conveniences and gains e. g. housing, fuel &c., and the continuity or unsteadiness and uncertainty of employment. High wages measured in money, may thus be accompanied by disadvantages inherent in some industries or incidental to the ups and downs of trade and manufacturing activity. Several factors have to be taken into account in judging of the sufficiency or otherwise of remuneration received by the labourer; and conditions in this respect are different in agriculture, cottage industries and factories of the modern type. The raw materials handled, tools and implements used, the machines looked after, the place and the time occupied, the residential accommodation obtained—all these tell upon the workman and the satisfaction he strives to wrest out of the product of his work. It should be borne in mind, besides, that even where some rise in real wages has taken place, it represents, in the majority of cases, only a slight advance of workers' low standard of living towards the region of a decent livelihood.

An inquiry into the relation of wages and the cost of living of Indian factory workmen made by some foreign representatives of labour[1] in 1927, revealed that the average wage in the cotton mills in Bombay, where the remuneration of workers is higher than almost all other industrial centres in India, was about Rs. 40 per month, that a few received Rs. 50 to Rs. 55 and that the large majority obtained Rs. 30 to 35, while the minimum cost of living was found to be Rs. 40 per month, so that for a family of five persons, the wages of a considerable number of workers, were insufficient, unless they were supplemented by the earnings of other members. The lot of weavers was better, and workmen doing skilled jobs earned higher wages. But the monthly wage of the spinner was Rs. 27 to 30. Women rarely received more than Rs. 9 per month, and the day labourer got about Rs. 14. Weavers in Ahmedadad, where the cost of living was lower than in Bombay, obtained Rs. 43, those in Sholapur Rs. 20 on an average and Rs. 38 in special cases, and those in Madras Rs. 27–30. At the last two places, spinners' wages amounted to Rs. 16

1 Karl Schrador and F. J. Furtwängler: *Das Weterktige Indian.*

to 18. At Cawnpur and Indore the weaver did not receive more than Rs. 20 per month. The authors of the book from which the above figures are taken, go on to show that the wages paid by certain tramway and railway companies in south India were very poor and characterise the wages paid in the jute mills of Calcutta as miserable. They feel convinced, from a study of the subject, of the truth of the remark that millions of people in India must be half starved. According to them, there is little to choose between Indian-managed and European-managed industries in the matter of the low wages paid to their workmen, though the latter are more efficient and productive. The severe depression which overtook industries in India in post-war years, particularly the mill industry in Bombay, was put forward as the chief excuse for a reduction in wages in the latter, but workers resisted both a lowering in their earnings and the proposal that, in the alternative, they should put in more work.[1] A prolonged and bitter lockout and strike were the result. On account of the unorganized nature of Indian labour, its wages are not strictly adjusted to the industrial conditions and to the level of prices and of the cost of living.

304. Factory Life:—As to conditions of work and living, they vary with the kind of industry in which the labourer is engaged. Work in the fields is, of course, the best from the point of view of the labourer's health, and though village sanitation in India is far from satisfactory, life in the open air and in cottages or small houses is preferable to residence in overcrowded tenements in cities. The labour of the cultivator and the farm servant and the simple life they lead in rural areas are a theme of appreciation with poets; and economists need not hesitate to join in the praise. The fact must not, however, be lost sight of that the work in the fields is seasonal and there are long spells of unemployment. To large numbers of village workers migration to towns and industrial centres means substantial relief from starvation. Then again, there is doubtless much sweating in some of the home industries; but on the whole, there is greater freedom enjoyed by operatives engaged in indigenous industries of the old type. Many modern processes of manufacture are full of danger to human life and most of them are more or less harmful to the workers' health. The temptations

1 See Fawcett Committee's Report.

of city life such as drink shops, are insidious, disruption of family life is dangerous and the physical and the moral condition of the operatives visibly suffers. The periodical migration of city labour to village homes affords relief though it disturbs the work in the factory.[1]

It is the monotony of attending to machinery, working in stuffy laces in the midst of constant noise and bustle, residence in over-crowded rooms and the continuous strain which labour in factories and workshops imposes, that tell upon the health of the operatives. The autonomous worker is his own master and he and the members of his family, who may have to work long hours, have still the consciousness of independence and enjoy an amount of liberty which is denied to the operatives working for a master. The latter have to toil at their wearisome task and their lot is often hard. The social effects of the factory system on labourers are very detrimental, especially when women are employed. There is no one to look after the children left at home and the domestic life of the operatives is rendered miserable. Coolies and artisans often migrate with their families to the vicinity of factories and mines, and men and women are employed at the same works. The wages they obtain are not a sufficient compensation for the detriment caused to the family and social life of the labourers. The women employed in the coal mines, for example, worked along with their men folk and often took the children down the mines. The proposal to prohibit the employment of women underground was met by employers with the argument that the prevailing practice was approved by the workers as being remunerative as well as harmless. But the legislature gave the mine workers the protection they needed.

The jobber supplies labour in several Indian mills and acts as a middleman. This system frees the employers from all worry about the recruitment of labour, but it places the workmen at the mercy of an irresponsible and often unscrupulous person bent upon personal gain. Wages are not paid weekly

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1 The Indian factory labourer is described by the Factories Commission of 1907 as follows:—"In almost all cases his hereditary occupation is agriculture; his home is in the village from which he comes, not in the city in which he labours; his wife and family ordinarily continue to live in that village; he regularly remits a portion of his wages there; and he returns there periodically to look after his affairs, and to obtain rest after the strain of factory life."

as in England and operatives have to borrow to satisfy their daily requirements. Wages are usually kept in arrears and are paid weeks after they are due. Children are made to work in factories when they should live a life of freedom in the open air, and this leads to the physical deterioration of the young generation of working men. There is no 'home' for workmen when their wives have also to work in factories. The health of children must suffer under these conditions. The position of artisans, like the carpenter, the blacksmith and the mason, is far better; their wages are high; they enjoy greater liberty and their work is not so taxing. Persons possessing skill and working in factories and workshops, occupy a similar position. Where works are situated in localities at a distance from crowded towns and accommodation is provided by employers, the operatives have not much ground for complaint. Residence in crowded and dirty 'chawls' and 'busties,' combined with work in mills and mines, brings on physical deterioration and disease.

305. First Factories Act :—It was, therefore, to the factory operatives that attention was early directed, and experience of western countries led the State in India to legislate for their protection. By the close of the third quarter of the nineteenth century, factory legislation had steadily expanded in England and a consolidating Act in connection with it was passed in 1878. During the twenty-five years preceding that date, the cotton and the jute textile industry had shown remarkable progress in this country, and attention of philanthropists and the rivals of Indian manufacturers in Great Britain was drawn to the conditions of work of the factory hands in Bombay and Calcutta. "In Bombay the first mill was established in 1851. By 1879–80 (the first year for which complete authentic official records are available), there were 58 cotton spinning and weaving mills in India with an aggregate of 13,307 looms and 1,470,830 spindles, and a daily average employment of 39,537 persons." The Secretary of State for India was urged in 1874 and 1875, by means of questions in Parliament, to order an inquiry into the condition of labour—specially the long hours for which women and children were made to work in the mills—in the Indian factories and he asked the Government of Bombay to make an investigation. The result was the Commission of 1875 which submitted its report in the July of the same year.

That philanthropy was not unmixed with self-interest in Great Britain in relation to the demand for State regulation, is shown by the warning of the Earl of Shaftsbury, a friend of factory labour, that raw material and labour being cheap in India, "if we allow the manufacturers there to work their operatives 16 or 17 hours and put them under no restrictions, we are giving them a very unfair advantage over the manufacturers of our own country, and they might be undersold, even in Manchester itself, by manufactured goods imported from the East."[1] The chief points considered by the Commission of 1875 and its views on them, are reflected in the recommendations that (1) machinery should be protected, (2) children should not be employed under eight years of age, (3) childern from eight to fourteen years should not work more than eight hours daily, (4) hours of labour, including one hour of rest, should not exceed twelve hours a day, (5) all factories should be closed one day in seven and (6) good drinking water should be provided in every factory.

The inquiry of the Factory Commission, which was restricted to Bombay City, was supplemented by investigation in other industrial centres in the Presidency, and the Government of India introduced a bill based upon the information collected and the views ascertained, in the central legislature in 1879. The first factory law to be enacted in India, viz. Act XV of 1881, which resulted from the bill and the discussion that it evoked, was made to apply to the whole of British India and it did not pretend to control adult labour, male or female. It gave local governments the power of inspection, and provided for the fencing of machinery and notifying of accidents and regulated the employment of children, the minimum of their age being 7 and the maximum 12 years, and their daily hours of work being restricted to a maximum of nine. The Act was to apply only to factories in which not less than 100 persons were simultaneously employed and power was used. The first Factories Act was thus a compromise between the principle of State regulation of the conditions of work in factories and the claim that the State should not interfere in the relations between labour and capital, and was, therefore, an exceedingly mild attempt at intervention on the part of the government.

1 For a good summary of the history of factory legislation in India consult Prof. J. C. Kydd's book on *Factory Legislation*.

306. Factories Act of 1891:—It was consequently inevitable that the legislation of 1881 should be regarded as inadequate for the attainment of the object in view; and the Government of Bombay set the ball rolling in 1884 by causing a fresh inquiry to be made at the hands of a representative committee. A Medical Committee was also appointed to examine the condition of the health of mill operatives. The Sanitary Commissioner was likewise asked to report on the state of sanitation in the mills, factories and workshops. Mr. Meade King, an Inspector of Factories in England, had been invited and had already reported on the working of the Factories Act of 1881. The proposals of the Commission referred to the following points:—(1) sanitary provisions, (2) raising the minimum age of employment of children to 9 years, (3) raising the age at which a child may be employed as an adult, to 14 years, (4) the restriction of hours of employment of women, (5) statutory provision for four holidays per month for women and children, (6) examination by a certifying surgeon of a child who is to be employed, (7) making obstruction to an Inspector punishable by law, (8) keeping and producing a register of children employed and (9) extending the Factories Act to factories in which not less than ten women and children are employed.

The Secretary of State for India continued to evince interest in the discussion of the above questions and there was a good deal of correspondence between him and the Indian government. The latter, while accepting the necessity of further legislation, was disposed to think that Indian conditions being peculiar, Indian factory law could not be made to correspond closely to the British Acts. Lancashire manufacturers did not, however, hesitate to declare that "the judgment of the Government of India has been warped by the clamour raised by Indian mill-owners who desire an unfair field for competition with England," and while the Indian government had introduced into the Central Legislative Council, in January 1890, a bill to amend the Indian Factories Act, the Secretary of State suggested in the May of that year that another commission of inquiry should be appointed and the proposal was given effect to in September. As a result of these investigations and discussions, Act XI of 1891, amending Act XV of 1881, was passed and came into force on the first day of January, 1892.[1]

1 Consult J. O. Kydd: A History of Factory Legislation in India.

The provisions of the amending Act of 1891, may be summed up in the following words taken from "Labour in Indian Industries"[1]—"This Act was a distinct advance on that of 1881. It was made applicable to all establishments using power where not less than 50 persons were employed while local governments had the authority to extend its provisions to places where not less than 20 persons were employed. Children were given a much ampler degree of protection. The age limits were raised to 9 and 14 respectively and the hours of work were limited to 7 in any one day and had to he between the hours of 5 A. M. and 8 P. M. A rest interval of one half hour's duration was also prescribed if the hours of work amounted to six. Restrictions were placed on the employment of women and they were not to work in factories before 5 A. M. and after 8 P. M. except in places where a system of shifts had been approved by the Inspector. Their hours were limited to 11 in the day and they enjoyed an interval or intervals of rest amounting to at least $1\frac{1}{2}$ hours if the full 11 hours were worked. The hours of work for men were not limited but there had to be a stoppage of work for half an hour between 12 and 2 and a weekly day of rest was also secured. Another feature of the Act was the introduction of provisions to secure ventilation and cleanliness and to prevent over-crowding in factories."

307. Factories Act of 1911:—The jute mills in Dundee had begun to feel the severity of the competition of the Calcutta factories; and in 1895, they urged the Indian Secretary of State to inquire into the alleged evil of the employment of women during night hours in the Bengal mills. This outside meddling in Indian industrial affairs was resented by the Calcutta manufacturers, and the local and central governments expressed the opinion that a case for investigation and further restriction had not been made out. For ten years, therefore, there was little activity in relation to the strengthening of the factory law, and it was only on the return of the Liberals to power in 1906 in Great Britain that textile workers in Great Britain took up the question of further legislation in India. The Textile Factories Labour Committee was appointed towards the close of 1906 by the Government of India and a commission was appointed in October, 1907 to complete and supplement the preli-

1 G. M. Broughton.

minary work done by the small committee. The commission made a comprehensive investigation and an elaborate report. It condemned the work of factory inspection as inadequate and inefficient and recommended an increase of the staff of full-time inspectors.

The increasing use of electricity in the Bombay mills made it possible for the operatives to work for 14 or 15 hours a day, and the industrial boom of 1904–05 rendered such excessive hours of work notorious. The majority of the Commission deprecated any limitation of the working hours of male adults. But they recommended the creation of a class of "young persons" between 14 and 17 years of age who were not to work for more than 12 hours a day, thus indirectly limiting the hours of work, for adults to 12. The reduction of the hours of children's work from 7 to 6 hours and the assimilation of the restrictions placed upon the employment of women to those proposed for the "young persons" class, had important consequences. The direct provision about the limitation of the textile operatives' hours of work to a maximum of 12 hours during any one day, made in the Act of 1911, was regarded by employers as extraordinary and as an unnecessary encroachment upon individual liberty. Some mill-owners indeed welcomed the restrictions as calculated to prove beneficial to the operatives and to enhance their efficiency. But others strenuously opposed the innovation as injurious to the interests of workmen as to those of employers. It was said that the evil complained of was not widespread; that the operatives did not want the limitation of hours; that they worked willingly for a longer time as they obtained more wages for the additional work; that the work did not put an excessive tax on the health or the energy of the workers; and that the agitation in the press for restriction was misleading and not entirely unselfish.

Employers stressed the fact that there was no similarity between the conditions of the work of western operatives and those of the Indian labourers. The disparity and the consequent undesirability of assimilating the Indian factory law to the corresponding law of England, were recognized by the Commission of 1907 which has presented the following pen picture of the Indian factory worker:—"The Indian factory worker is, in general, incapable of prolonged and intense effort; he may work hard for a comparatively short period, but even in such cases the standard attained is much below what would be expected, in similar circumstances, in any

European country. His natural inclination is to spread the work he has to do over a long period of time working in a leisurely manner throughout and taking intervals of rest whenever he feels disinclined for futher exertion. Meals are generally eaten during the working hours of the factory; the midday interval is sometimes devoted to sleep; and the operative leaves his work frequently throughout the day in order to eat, smoke, bathe and so on." Working the factories for reasonable hours appeared to the Commission as one of the cures for the slackness of Indian labour.

The Indian factory labourer has produced upon visitors from foreign countries the same impression as the one expressed above and echoed by the representatives of capitalists in the debates in the Imperial Legislative Council, on the Factories Bill of 1910.[1] But his laziness and lack of concentration did not justify excessive hours of work at noisy, nerve-racking machines in the midst of surroundings that were bound to prove harmful to his health. And the accounts which were published, of the conditions in which the mill hands lived and worked and earned their wages, could not but excite the sympathy of the public; and, in the long run, it was felt that the employers themselves were bound to suffer owing to a loss of efficiency in their workpeople. Factory owners are not, however, inclined to look ahead or feel for their labourers as they feel for their own profits; and though there are honourable exceptions, this is the usual conflict of interest between capital and labour. The interest taken, for half a century, by Lancashire manufacturers in the condition of Indian factory labour, especially that engaged in the cotton textile industry, created an atmosphere of suspicion round the labour problem and complicated the situation. Political influences brought to bear upon Indian labour from abroad and within the country, have had a similar effect.

308. Labour Organization :—Labourers in India have been, until recently, almost absolutely unorganized,[2] ignorant and unenter-

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1 3rd January, 1911.

2 " For the present the condition of the Indian working man is wonderfully like that of the English working woman. He does not understand his own position well enough to enable him to act effectively. Only the faintest glimmer of Trade Unionism is streaking his horizon with light."—J. Ramsay Macdonald; The Awakening of India.

prising. The Indian factory worker does not generally settle in or near the industrial centre; he has his ancestral home and patch of land, perhaps the property of a joint family, to which he returns during certain seasons of the year. He has been described as 'an agriculturalist first and an agriculturalist last.' He supplements the family income by his wages as a factory operative. A proletariat is being steadily formed in this country; but it does not consist, as in the West, of landless men who have made crowded cities their homes and places of work year in and year out and who have little to draw them away to the village. This is, from one point of view, a satisfactory feature of the workman's life; but from the point of view of the work in the factory, it leads to disorganization and waste. "The employer of labour in this country," it is said therefore, "is wholly at the mercy of his operatives."

The population of factory workers is not homogeneous though persons hailing from the same parts of the moffussil are found to congregate and to have a community of feeling and interest. This makes industrial centres places of only temporary residence and the prospects of workers are not indissolubly bound up with the localities and the industries in which they are employed. These factors, combined with the ignorance and the illiteracy of labourers, do not make them suitable material for organizations equipped for concerted action conducive to common good. Now and again, small strikes occurred among factory hands, in the past; but the use of this weapon was neither systematic nor sustained. Railway, postal and telegraph employees could achieve some measure of success owing to their advantage in matters of education, social status and financial position. The strikes among factory workers at Ahmedabad and of postmen in Bombay in 1918, showed how a substantial increase of wages could be obtained by concerted and sustained action on the part of mill operatives and government employees and also how employers could resist extravagant demands by means of organised opposition.[1] The strike was for a long time only a mild way of ventilating grievances and there were no labour organizations behind the workmen most of whom are illiterate. Neither employers nor workmen, as corporate bodies, had made satisfactory arrangements for the performance of functions which trade unions

1 The total number of strikes reported durnig the year 1923 was 214 as against 280 in the preceding year and above 400 in 1921.

in the West have taken upon themselves. The union and the solidarity temporarily created by the intensification of a serious grievance or forced by active agitation among workers, have rarely survived the success or the failure, total or partial, of a strike. The male and female jobbers (the Naikins of the Bombay mills) are hardly capable of organization work and are only labour-supply agents.[1]

During the past few years, however, systematic efforts have been made to organise labour; and labour unions were first started on systematic lines in Madras. Bombay, Ahmedabad, Calcutta, Jamshedpur are now important centres of labour unions, and the attempt is being made to run them on western lines. Railways and the Docks furnish conditions which are specially favourable to organization. There are, in the unions, committees of management and secretaries, many of whom are outsiders and voluntary workers, and monthly subscriptions are taken from members. The funds thus collected are, however, far from adequate for the performance of any of the functions characteristic of trade unions. Even during strikes, the workers have to fall back upon public charity. The movement is steadily spreading and different classes of workers, in different parts of the country, are being organized in unions. It will take years before they assume the shape, the functions and the strength of labour organizations in Western countries but they are clearly moving in that direction. An All-India Labour Conference, convened to elect a representative for attending the international labour conference, was a significant move and showed the trend of the development in India. The Indian Trade Union Congress is now the recognized central organization for this country.

309. Trade Unions and Legislation:—It will thus be seen that the trade union movement in India is still in its infancy. The

1 "The jobber is still the master of the situation and finds it to his interest that there should be frequent changes among the hands":—Collector of Bombay, reviewing Report of the Chief Inspector of Factories in 1912. J. Ramsay Macdonald thus describes the situation:—" One finds this industrial class swarming in over-crowded coolies' lines, sometimes regimented by an overseer to whom the workers owe their job and who in consequence demands commissions from them, sometimes living in ordinary working class parts of the town under exceptionally hard conditions."

umber of the unions fluctuates from time to time, and some of them are only paper organizations. Statistics regarding these bodies must, therefore, be taken with considerable reservation. There are in the whole of India about 170 trade unions with a total membership of well-nigh upon 2½ lakhs. There are in Bombay city alone a dozen well-regulated unions, most of them started in the course of 1920 and 1921 with a membership ranging between 350 and 10,000 each. Ahmedabad has 10 unions, which are believed to be well-managed. There were no less than 36 unions in the Bombay Presidency in the year 1925 with a total membership of 50,000. The natural development of the increase in the number or trade unions is the creation of federations. The Ahmedabad Labour Union is thus a federation of five separate unions of cotton mill workers in the capital of Gujarat. This is one of the best organized federations in the country and it pays to its members several 'benefits' including the strike and victimization benefit. It conducts schools and maintains a hospital and lends money at cheap rates. Its membership is 14,000. The All-India Postal and R. M. S. Association has a membership of 30,000 and the same membership is shown by the All-India Railwaymen's Unions' Federation. Many of the workmen's associations are not trade unions in the accepted sense of the word and have no regular funds and do not function as active unions.[1] The All-India Trade Union Congress started to combine the trade unions with its headquarters in Bombay. Forty unions embracing varied industries and trades have been affiliated to it and it represents over 1,00,000 workers in India. Regular membership, punctual payment of subscriptions, a strong and active executive and continuous effort for the progress of the movement, Which are the characteristic features of trade unionism in the West, are still lacking in India, and it is to be seen how development shapes itself in the near future.

In the meanwhile, questions of tremendous importance to labour, such as legislation in connection with the registration and protect-

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1 According to the Industrial Disputes Committee of 1921-22, nominally there were in existence at the time of its inquiry, 18 unions with 79,614 members in Bombay, 12 unions with 20,863 members in Ahmedabad and 17 unions with 8,254 members in the rest of the Presidency. The Committee observes :—"Strike Committees arise calling themselves trade unions and demanding the privileges of trade unions without any means of discharging the responsibilities thereof...... But these are the growing pains of trade unionism...... "

tion of unions had been under discussion and measures to establish a suitable machinery for conciliation and arbitration were being thought out. As Mr. Montague, when Secretary of State for India, in reply to a deputation that waited on him in connection with trade union legislation contemplated in this country, said: "there is no provision in India for the registration of trade unions; there is no provision in India for vesting the property of trade unions in Trustees with power to sue and liability to be sued in respect thereof; there is no legislation in India for the protection of trade unions against certain actions of tort or in peaceful picketing." All these matters had to be provided for by effective legislation. Trade unionism and legislation in connection with it, have grown steadily in England in the midst of severe trial and trouble, and adjustments have been made from time to time as they were found necessary. British labour legislation will provide a valuable guide in India but it will have to be modified in important respects before it can be applied to the conditions obtaining here. The problem bristles with legal and practical difficulties, but it had to be faced; and there was a consensus of opinion in the country that trade union legislation calculated to protect and to facilitate the progress of labour, was urgently required. The Trade Union bill introduced by the central government, in 1925, provided for the optional registration of unions and granting special privileges to registered bodies with respect to immunity from civil suits and criminal prosecutions. With a few modifications it became an Act in 1926. This piece of legislation will be referred to again later.

Labour strikes and lockouts having now become a familiar feature of the industrial life of the country, the question naturally arose, if it was not possible to compose the differences between employers and their workmen in an amicable manner so as to avoid the waste, the hardship and the bitterness that the struggle always creates. A good deal of experience has been gained in this connection in other countries and the machinery of voluntary and compulsory conciliation and arbitration has been set up with a considerable amount of success. In 1921, the Government of Bombay appointed the Industrial Disputes Committee, on the recommendation of the provincial Legislative Council, "to consider and report upon the practicability or otherwise of creating a machinery for the prevention and early settlement of industrial disputes." The com-

mittee came to the conclusion that in all cases of dispute a Court of Inquiry should be constituted on the application of either party, that a court of conciliation should be constituted only on the application of both parties to a dispute and that Government should have power to move without the application of either party only when peace, order and good government are seriously prejudiced. The central government was expected to legislate for this purpose, but did not immediately move in the matter. All-India legislation has been attempted for providing for the formation of panels representing different interests out of which boards are to be selected for investigating causes of dispute with a view to bring about a settlement. Works committees have recently been established in some factories with a similar object and a few of them are reported to be doing well.

310. Employers and Labour:—A few conscientious employers are trying to provide good houses and other amenities of life to their workmen and education to their children; and the arrangements made in this connection are satisfactory. The example must, however, be widely copied and employers must realise that action in this direction is as much in their own interest as in that of the working men. No one would like to have here the labour troubles that have now become a common, chronic feature of industrial life in the West. But the remedy for this does not lie in keeping workmen ignorant, indifferent and unorganized; it lies rather in timely measures taken to avoid the mistakes and to prevent the evils of the West. The time seems to be coming when the Indian workmen will appreciate the remark of a leader of Western labour that "one with an experience of the West must look upon this commercial philanthropy with grave misgiving, whatever immediate benefit it may be to the workers."[1] While on the one side, labour does not want to receive charity from the employers, the latter resent what they regard as the intrusion of their operatives into the sphere of capital and feel discouraged in actively promoting the welfare of these people.

In the face of the illiteracy that prevails in the country and of the apathy on the part of the workmen as well as of employers, the solution of the problem is very difficult. The operatives are at the mercy of jobbers and money-lenders to whom they are driven by

1 J. Ramsay Macdonald.

ignorance,[1] extravagance and vice. Disorganization of the old social and economic system and illiteracy are the two principal obstacles in the way of the promotion of the well-being of the working classes. The problem must be tackled from the two ends, the employers and the workpeople. The employers in their own interest, have to organize the supply of labour and promote its efficiency. The labour population in towns is a floating population and employers are not sure if their money would be usefully spent on its improvement. But it is pointed out that if life in the centres of industry is made more attractive than it now is, the workmen may be induced to live there more or less permanently, in spite of their attachment to the village home and lands. The proper housing of factory hands, the education of their children and a general improvement in the conditions of work in factories, are directions in which reform is required. There has already been much talk about these questions, but there are only a few isolated instances of employers who have taken them up seriously. On the whole, there is apathy and lack of concerted action in these matters.[2]

In other countries there are splendid organizations of workmen and they have now won for themselves an important place in public life. Their action is both beneficent and militant. The trade unions help their members in a variety of ways and try generally to improve the position of the working classes. On the militant side also they have won notable successes, particularly in lessening hours of work and increasing wages, and the State itself has come

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1 "It should always be remembered that the Indian labourer must be led and not driven. He is not as is the inhabitant of western lands consumed by the desire to rise in the world. The caste and joint family system hold him back and he is content with the simple fare and surroundings as his father had before him. If dissatisfied with conditions of work in towns he will make no complaint but go back to his village life."—Fremantle: Report on the condition of labour in the United Provinces.

2 In the Tata Iron and Steel Works at Jamshedpur up-to-date and ideal arrangements have been made for the housing and the general comfort of labourers. But even there, these are inadequate and there was, in 1920, a strike on a large scale which was repeated a few years later and which indicated the advent of new conditions. Employers of labour in several cotton mills and other factories are also making similar provision. 'Welfare funds' have thus been started in connection with certain mills in Bombay and large amounts taken out of profits are utilised in promoting the well-being of the operatives. Dispensaries and grain shops are attached to factories and chawls have been erected in the vicinity of mills for housing workmen.

to the assistance of the labourers by making arrangements for old age pensions, insurance against sickness and disablement. There is unfortunately a tendency among workmen to go to extremes in the matter of strikes and hence they have lost public sympathy which is their great asset.

Unskilled labourers and women are, as a rule, at a disadvantage and have to be content with low wages and unsatisfactory conditions of work. But workers in docks and other places where great physical strength is required in lifting and carrying about heavy loads earn high wages. In India, labourers are scattered, except in large industrial centres, and concerted action is impossible in their case. The old caste organizations are unsuited to factory life as in factories there is a promiscuous mixing up of different castes. The lives of operatives have to be adapted to their environments so that they may try to improve them. Even where workmen are congregated in numbers, they are helpless, without leaders and without organization. Spread of education among them will alone enable them to understand their rights and to make efforts to improve their condition.

The lot of the labourers engaged in factories, mines, railways and on plantations may be improved by the beneficent action of far-seeing and sympathetic employers, as much as by combined pressure brought to bear upon them by the operatives. In agriculture and the other indigenous industries in which the bulk of the Indian labourers are engaged, combined action on the part of workmen is not to be expected and the good sense of the employers must be trusted to ensure satisfactory conditions of work and decent wages. There is a large amount of casual labour employed in these industries, and its wages are determined by the number and the needs of the workmen. The employer will usually give his labourers just enough to enable them to keep body and soul together and they are often at his mercy. Such labour is inefficient and dear even for low wages.

311. Housing and Sanitation:—Workers in factories, in mines and on the plantations form a small part of the total labour force of the country. The condition of factory workers has attracted greater attention because it is more conspicuous and it involves the evils of modern industrialism. But there is no reason to suppose

that workmen engaged in other industries are better off, though there are in their position certain compensating circumstances present. Now that labour is being organized and is preparing to take the problem of improvement in its own hands, it may be expected that progress in the direction of higher wages, fewer hours of work, sanitation, housing etc., will be steadily kept in view and systematic efforts will be made to achieve it.

It is often stated that the efficiency of Indian labour is comparatively low[1] and that the Indian workman is content with a very low standard of comfort. It is said that "the Indian workman, speaking generally, takes advantage of the greater earning power given to him by increased wages to do less work, and shows no desire to earn more money by working more regularly or by improving his own efficiency." The Industrial Commission made a careful enquiry into this aspect of the labour problem and was inclined to take the view that 'the remedies for this state of affairs are a rise in the standard of comfort and an improvement in public health.' The Tariff Board found that considering the wages obtained by labour in the organized industries of the country, its efficiency was not low, though employers complained that workmen were not ambitious and did not care to earn more with greater regularity, skill and efficiency. Education, improved housing and a general policy of betterment, in which an organization for the care of public health must play a prominent part, are the means suggested to attain the desired end. Shorter hours of work, facilities for recreation, provision of cheap shops for the sale of articles of every day consumption, co-operative societies, are some of the principal measures that must be taken to bring about a substantial improvement in the condition of factory labour.

The housing problem is one of the most urgent that must be tackled in this connection. Large-scale production means the concentration of workers in restricted industrial localities which have the inevitable tendency to become congested. Conditions in this respect vary from industry to industry and from province to province. In cases where factories are situated at a distance from towns, decent housing accommodation can be conveniently provided though even there, employers are unwilling to meet the large initial cost required therefor and incur it because labour would not be attracted and

1 See pages 178-179 above.

would not become stable otherwise. But in places where factories are located in thickly populated areas and in places where cheap and sufficient land is not available, housing conditions are unsatisfactory. Government and local authorities must co-operate with employers in securing suitable sites for erecting factories and housing workmen. The duty of providing sanitary houses, can not be thrown entirely on the shoulders of employers, though the latter must not shirk their responsibility in the matter. Some enlightened employers have been alive to their duty, and housing arrangements made and the social and intellectual amenities provided in certain mills and factories are worthy of imitation elsewhere.

The position of Bombay city with reference to the location of mills and housing, is peculiar. A few of the 'chawls' occupied by factory and other workers, constituted the worst accommodation that could be imagined.[1] The Report of the Industrial Commission described them thus :—"The rooms, especially those on the ground floor, are often pitch dark and possess very little in the way of windows; and even the small openings which exist, are closed by the inhabitants in their desire to secure privacy and to avoid the imaginary evils of ventilation. The ground floors are usually damp owing to an insufficient plinth; the courtyards between the buildings are most undesirably narrow and, therefore, receive insufficient sun and air. They are also very dirty. Water arrangements are insufficient and latrine accommodation is bad, though the latter is being steadily improved. An insanitary smell hangs round these buildings." The one-room tenements occupied by a large proportion of workers produce heavy infant mortality and destroy the privacy and the decency of domestic life. Increased accommodation in healthy model chawls has now been provided in Bombay and radical improvements have been effected by the Development Department. But unfortunately many of the chawls have remained unoccupied. The 'basties' about the jute mills near Calcutta are not huge structures like the Bombay chawls but are perhaps hardly less insanitary and over-crowded.

312. Welfare Work:—As work in factories is strenuous and exhausting, it is necessary that special measures should be taken by the employers to relieve the physical and the mental pressure which

1 Report of the Indian Industrial Commission, Chapter XVI.

long hours entail upon the operatives. The State must enforce the provision of these essential conditions in the factories if employers require legal coercion. First, as regards hours of work, employers gradually showed their willingness to adopt a ten hours' day. The contention that the Indian labourer is lazy, that he is not unwilling to work for twelve or more hours a day and that a shortening of the working day will inevitably lead to a reduction in output, and therefore in wages, is no longer seriously advanced, owing to the progress which ideas and practice have made during recent years. In order to put in twelve hours' work in the factory, the operative had to leave home at 5 or 5–30 A.M. and he returned at 8–30 or 9 P.M. He had no time for recreation and had no leisure : and life to him was not very pleasant. Relief was, therefore, imperatively necessary even if it caused some diminution of output and if a reduction of the working day did not increase the efficiency of labour. Humanitarian considerations, if nothing else, demanded it.

The employment of women and childern was a question that required even greater attention. Hours of work needed reduction and adequate rest had to be provided for in their cases. It will be seen that there are, besides, several questions of social and moral importance which arise with reference to the way in which women and childern are treated and the special concessions that must be granted to them. Employers naturally look at the questions from the point of view of their profits; the State has to consider the larger interests of the community as a whole. There are complaints that the law with reference to children is notoriously evaded in several factories, and that the inspectors are not able to cope with the evil. There was recently a suggestion made to the effect that unofficial and philanthropic agency should be allowed to co-operate with and supplement the work of factory inspectors; and though there are practical difficulties in putting this proposal into operation, it is undoubtedly worth a trial. In any event, a stricter and more frequent supervision of factories is badly needed, and the number of inspectors must be increased.

It has come to be recognized as a duty of employers to make varied provision for the physical, mental and moral well-being of their operatives; their responsibility does not end with paying the latter their fixed wage and perhaps accommodating them in sanitary houses. The Carnatak and Buckingham Mills in Madras, the Tata

Steel Works at Jamshedpur and a few mills in Bombay, Sholapur and Nagpur have been following a very liberal and far-sighted policy in providing houses, cheap grain shops, recreation grounds, libraries and other amenities for the benefit of their work people. Philanthropic agencies have undertaken this very useful work in Bombay and Madras, the Social Service League taking the lead at the former place. These bodies of public-spirited people organize lectures and conduct night schools for the benefit of factory workers. Outdoor games and trips are arranged for the children of the operatives and co-operative credit and other societies have been started for promoting thrift and relieving indebtedness. Special care is being taken to help women in their difficulties and more along these lines is required.

Some employers in Bombay have shown active sympathy with this work and have given financial help, enabling it to be carried on for the advantage of the operatives in their mills. But the recent conflicts between them and the workers have cooled the ardour of the former. The Indian Industrial Commission emphasised the value of these activities of philanthropic agencies and urged the need of disintersted labours of private individuals and associations being bestowed upon the work. Such agencies, it found, were sadly lacking, with one or two brilliant exceptions. The Commission felt that official organizations, as at present constituted, were ill-suited for work of this character and observed:—" Government and local bodies as well as employers, however, can and should assist such efforts, both financially and in other ways; but the direct participation of official agency in social welfare work must wait until the civic sense has become more fully developed, and we therefore think it out of place to make definite suggestions."[1] Municipal corporations can conveniently look after the welfare of their employees, with the assistance of cooperative societies and bodies of voluntary social workers; e. g. in Karachi, Bombay and Madras.

It must be repeated that the particular attention that is being paid to the question of ameliorating the condition of factory labour does not warrant the inference that other workmen are too well off to require anything being done for their benefit or that at least they

1 Report, page 192.

are not worse off than mill hands. The houses, the wages, the conditions of work &c. in the case of non-factory labour are, in most cases, lamentable. Organization is difficult among them, and their cause also must be taken up by philanthropic associations. Every town and even every village has this problem to face, and the city slums and the 'paracheries' are a scandal. Filth, vice, disease, poverty and misery are rampant in these places. Improvement of general sanitation and of public health is a problem of supreme importance which confronts municipal and local bodies and until it is solved, there is little prospect of any substantial bettering of the condition of labour. The conditions in which the depressed classes live and work are attracting increasing attention, and they illustrate the observation made above, regarding the state of non-factory labour.

313. Government Action:—The serious labour unrest which prevailed in the different parts of the country and broke out, from time to time, into strikes naturally raised the question whether the circumstances did not call for an inquiry into the condition of factory workers and did not point to the necessity of some measures being taken to establish conciliation boards and a system of arbitration. A resolution was moved in 1919, in the Supreme Legislative Council, urging the appointment of a commission to go into the whole problem of factory labour, strikes and so forth and to deal with the extraordinary labour situation which had arisen in the country. Speaking on behalf of government, Sir Thomas Holland expressed sympathy with the object of the resolution and described what steps were being taken to carry out the recommendations of the Industrial Commission in that behalf. Reference was made to the necessity of primary education among the labouring classes, to the position and prospects of skilled artisans, to the effects of a low standard of comfort of factory labour on its efficiency and to the welfare work among the operatives. It was stated that there was a keen demand for factory labour in the country and little apparent desire on the part of workmen to increase their efficiency and little prospect of their being able to do so. Labour, it was declared, was growing more conscious of its wants and power and showed signs of a capacity for organization. An examination of the whole position was, therefore, called for with a view to the devising of suitable remedies.

The Bombay mill strike of January, 1920 characterised as a 'lightning' strike, declared without any notice being given to the employers, roused a great deal of bitterness in the minds of employers, workmen and the public. The mill hands were obstinate in refusing to return to work until their demands about higher wages and other concessions were fully conceded, and the employers would not make a move unless the workers first went back to the mills. A deadlock was thus created and the labour situation bore a most threatening aspect; and an agreement was reached only through the intervention of a conciliation committee composed of public-spirited leading men, and especially of the Governor. A similar situation had to be faced in Ahmedabad at a later date. There were as many as 86 strikes in the course of a few months during that year. Nearly one-third of these involved more than 1,000 workers in each case and a total of nearly $2\frac{1}{8}$ lakhs of operatives. All this pointed to the urgent necessity of the government devising a machinery for dealing with the labour problems which had arisen in the country. The Factory Act clearly required amendment and other measures intended to meet labour conditions, characteristic of western countries, became obviously necessary. It was not, of course, possible to apply western methods wholesale to India and Indian labour could not be dealt with without special reference to local peculiar conditions.

The principal demand of factory workers during the strikes was for a rise in wages and a special allowance to cover the increase in the cost of living due to prevailing high prices. It was not only operatives in factories that struck work from time to time. The strike weapon has been used by postal and railway employees and municipal scavengers and tramwaymen with varying success. Labour was not, however, sufficiently organized, trained and experienced to make a grievance of the management and the conditions of work in the factories; but a claim to secure a reduction of the hours of work was being put forward. The fact that an international labour conference had met at Washington and approved of certain conventions, encouraged labour in this country in asking for concessions which had not figured as important demands in industrial disputes before that time. The problem of factory labour was thus brought to a head by a combination of various circumstances and the adoption of some conventions and

their embodiment in an amended Factory Act became inevitable. In spite of the provisions of factory legislation, occasions arise,[1] from time to time, in the disputes cropping up between capital and labour when the intervention of the executive government and the legislature is sought. Deputation of workmen and employers wait upon the heads of governments with requests that conciliation and arbitration may be attempted to prevent or end strikes.

314. India and International Labour :—The international treatment of questions relating to labour legislation had been tried off and on for a number of years in Europe, but the important part labour had played in winning the war for the Allies, forced the claims of the working classes on the special attention of the Powers which met to formulate the terms of peace with Germany early in 1919. The Paris Peace Conference appointed a Commission to inquire into the conditions of the employment of labour and the international machinery that should be devised to take common action on matters relating thereto. The labour convention proposed by the Commission was adopted by the Peace Conference and it provided for the constitution of an international organization to which all members of the League of Nations would belong and which would consist of an International Labour Conference and an International Labour Office as part of the machinery of the League. It was provided that the first Labour Conference was to meet at Washington in October, 1919.

How labour shot into international importance as a result of the War and the peace treaty, may be seen from the significant fact that the very Convenant of the League of Nations which is embodied in the Peace Treaty, contains, in Article 23, declarations regarding the obligation of the nations to take steps to "secure and maintain fair and humane conditions of labour for men, women and children;" and Part XIII of the Peace Treaty contains the necessary provisions relating to the international treatment of labour questions. India is an orignal member of the League and was also entitled to representation in the Labour Conference as a separate contracting party. Special treatment of countries like India, where labour conditions

1 A recent instance was that of the proposal of the Bombay mill owners to make a cut in the wages of their operatives as one of the remedies to meet the prevailing depression.

are not precisely similar to those obtaining in Western countries generally, was provided by Article 405 of the Treaty, which stated that the Conference shall have due regard to those countries in which climatic conditions, imperfect development of industrial organization and other circumstances make the industrial conditions substantially different, in framing its recommendations. Delegates to the Conference were to be representatives of employers, workmen and governments and were to be nominated by the last of these.

The first International Labour Conference held at Washington, passed draft conventions on the questions of the maximum weekly hours of work, the prevention of and provision against unemployment, the employment of women and children in unhealthy processes, employment of women before and after child birth and during night time and the question of the minimum age for the employment of children and the employment of children during night. So far as India and other Asiatic countries were concerned, these conventions were suitably modified to fit in with their peculiar conditions. An 8 hours' day and a 48 hours' week were adopted for general application, but it was provided that "in British India the principle of a sixty hours' week shall be adopted for all workers in the industries at present covered by the factory acts administered by the Government of India, in mines and in such branches of railway work as shall be specified for this purpose by the competent authority." A sixty hours' week had already been voluntarily adopted by the employers of labour in many of the Indian factories, but the Washington conventions needed the ratification of the Legislature before they could be enforced.

The draft conventions were accordingly submitted to the two houses of the Indian legislature in February, 1921, and ratified by the Government of India. Besides ratifying the two important conventions relating to the 60 hours' week and the fixing of the minimum age of children for admission to factories at 12, government ratified a convention regarding unemployment which binds them only to supply statistics regarding unemployment to the International Labour Office. They also undertook to examine recommendations of the conference about unemployment which sought to prevent exactions by private employment agencies from labourers for finding out work for them, by prohibiting the establishment of such agencies

as charged fees or carried on that business for profit. They, likewise, undertook to enquire into the possibility of making arrangements for the disinfection of wool infected with anthrax spores and to bring in legislation if it was found necessary to prevent the infection. The Washington recommendations respecting the protection of women and children against lead poisoning were also to be given effect to. They decided to examine, at the same time, the possibility of giving effect to the recommendation concerning the establishment of government Health Services. There are some unhealthy processes in manufacture and it was intended to provide, if necessary, besides an efficient system of factory inspection, a health service to look specially after sanitation and health. The improvements suggested by the conventions were, as far as practicable and essential, embodied in an amended factory law which became the Factory Act of 1922 and came into operation on 1st July, 1922.

315. The Factories Act of 1922 :—In view of the principal provisions of the Factories Act of 1911, the new Act was regarded as a very radical measure, and many of the changes embodied in it, were strenuously opposed by the representatives of employers of labour, though even they had become convinced of the inevitable character of the changes which were sought to be introduced. The Act of 1922 demonstrates the undoubted effect on India of organized strength built up by labour in western countries and the beneficial influence upon the condition of working classes in this country of international discussion and agreements in connection therewith. It is doubtful whether radical amendment of the Indian Factories Act of 1911 would have been possible in such a short time and without much fuss if it had not been for the pressure of international conventions and the increased political consciousness which had developed in this country since the war and the inauguration of the Reforms of 1919.

We give below a brief summary of the important changes embodied in the new Factories Act .—

The age of application of the law to children is raised from 14 to 15.

The definition of 'factory' is extended to any premises in which mechanical or electrical power is used employing simultaneously not less than 20 persons on any one day in the year and it

may also be applied to any premises where not less than any 10 persons are simultaneously employed whether or not mechanical power is used.

No child can be employed without a medical certificate, and wider powers are given to an inspector when he is of opinion that a child employed in a factory is no longer fit for employment, to require that the child shall cease to be employed until he has been re-examined by a certifying surgeon.

A new provision prohibits the atmosphere of a factory being rendered so humid by articificial means as to be injurious to the health of the persons employed.

The inspector is given authority to compel the repair of buildings or machinery which are in a condition dangerous to human life or safety and in the case of imminent danger he may prohibit the use of machinery or plant until it is duly repaired.

Power is given to prohibit the presence in factories of children under the minimum age of employment.

The employment of women and persons under 18 years is prohibited in zinc or lead works, in the manufacture of solder or alloys containing more than 10 per cent. of lead or mixing or pasting in connection with the manufacture or repair of electric accumulators.

There are new and stringent provisions to protect the health of workers in zinc and lead.

The rest intervals at periods not exceeding six hours are to be for not less than one hour instead of half an hour, and no person is to work for more than five hours continuously and in the case of a child for more than four hours.

While another rest day than Sunday may be substituted, the change must not result in any person working for more than 10 consecutive days without a whole day's holiday.

The maximum hours for child employment in each day are reduced from seven to six hours.

The minimum age limit for children is raised from 9 to 12, but this will not apply to any child lawfully employed in a factory on or before July 1, 1921.

No person is to be employed in a factory for more than 60 hours in any one week (the previous limit was 72) or for more than 11 hours in any one day.

Certain powers of general or special exemption from these restrictions may be given by the local Government to meet seasonal or other exceptional conditions or to carry out work on urgent repairs.

Where such exemption is granted, overtime beyond the 60 hours a week is to be paid for at not less than $1\frac{1}{4}$ times the normal rate.

The statutory limitation of hours does not apply to persons defined by rules to be holding positions of supervision or management or to be employed in a confidential capacity.

There may be special exemptions for indigo, tea and coffee factories but in prescribing them the local Government is to be subject to the control of the Governortl General in Council.

The Governor General in Council is empowered to make rules for the adequate disinfection of wool for the prevention of anthrax.

The fine for breaches of the Act is raised from Rs. 200 to Rs. 500; and the Court is empowered to pay compensation to injured persons or their families out of the fine.

316. Later Developments:—Though the trade union movement in India is still in its infancy, the number to factory hands bears a small proportion to the total number of workers of all classes, and in the large majority of cases, the leaders of the movement are outsiders, inspired with sympathy for the cause of labour or desirous of introducing into this country a system of labour organization and a spirit of class hostility peculiar to the west, as a remedy for the evil of modern capitalism taking root in Indian soil, the need of improvement, from the point of view of operatives, in the organization and the conduct of industries and of the amelioration of the condition of workers, is recognized on all hands. Even the employers have come to concede the necessity of measures to organize and protect labour though they complain that workmen who have learned to strike and fight for higher wages and rights, are not inclined to enhance their efficiency and productivity. The place which

labour has secured in international organization set up and supported by the leading countries of the world and its admission to an international brotherhood of workers, have raised its status and armed it with effective weapons for self-improvement. The experience of the west is being fully drawn upon to provide lessons for solving industrial problems in India; and legislative and other measures are being taken to safeguard and promote its best interests. Labour questions are, likewise, being discussed in bodies in which the workers are avowedly represented. The second labour conference was held in 1920 at Genoa and considered questions regarding the conditions of seamen's work. The Indian government did not ratify any of the conventions but instituted an inquiry into the methods of seamen's recruitment. The third international conference was held at Geneva in October, 1921 and considered questions mainly regarding agricultural labour. The seventh session was held at the same place in May, 1925, and among others, discussed the question of workmen's compensation. Special reference to later conferences is not here necessary. The value of the deliberations and resolutions of these conferences to Indian labour will depend not only on the advocacy of its cause before the meetings of that body but on the effect that will be given here to the recommendations made.

The effect of the above influences on the policy and the action of the Indian government and the legislature has been considerable, though the pace with which legislation for the benefit of labour has proceeded, has not given satisfaction to the supporters of the interests and claims of factory workers. Thus the legislation in favour of conciliation and arbitration proposed for Bombay and transferred to the central government as falling within its purview, did not long materialize though the bill framed to provide for the investigation and settlement of trade disputes was before the country for a long time, and the maternity benefit bill, intended to provide support to women workers before and after child birth, has been rejected by the Legislative Assembly. The trade union bill evoked a good deal of dispute on the controversial points relating to the use of union funds for political purposes and to the composition of the executive and controlling bodies, and its passage through the legislature was stormy. The enactment of the Workmen's Compensation Act in 1923, was, however, a notable

measure, a piece of legislation copied from the English Act, and calculated to make the employer liable for the payment of compensation to his workmen for injuries received while engaged in industrial operations. The actual wording of the Act is that "if personal injury is caused to a workman by accident arising out of and in the course of his employment, his employer shall be liable to pay compensation in accordance with the provisions of this chapter: Provided that the employer shall not be so liable (*a*) in respect of any injury which does not result in the total or partial disablement of the workman for a period exceeding ten days; (*b*) in respect of any injury to a workman resulting from an accident which is directly attributable to (*i*) the workman having been at the time thereof under the influence of drink or drugs, or (*ii*) the wilful disobedience of the workman to an order expressly given, or to a rule expressly framed, for the purpose of securing the safety of workmen, or (*iii*) wilful removal or disregard by the workman of any safety guard or other device which he knew to have been provided for the purpose of securing the safety of workmen, or (*c*) except in the case of death or permanent total disablement in respect of any workman employed in the construction, repair or demolition of a building or bridge." The Act goes on to specify the circumstances in which compensation shall be claimable and lays down the procedure in that behalf and prescribes the amounts that shall be paid.

The evil of unemployment has, of late years, become acute in this country. It is very largely associated in the west, with specialized production of wealth which depends more or less upon foreign demand. The war having reduced the world's purchasing power, large numbers of workmen have been thrown out of employment and Great Britain has had eleven lakhs of unemployed at one time receiving a dole from the State. Unemployment is chronic in Indian agriculture during the dry season; and the rural population has to search for work in urban areas. The economic and the social revolution which has silently proceeded in the country, has brought about unemployment among the middle classes, and the growing competition for such jobs as are available is being felt by educated youths and by the Anglo-Indian community, among others, for example. The maladjustment of the educational system with industrial organization, is to a considerable extent, responsible for much of

the unemployment and the evil has been aggravated by the economic depression which succeeded the close of the war.

317. More Legislation :—As the labour movement developed, the need for legislation for two purposes was strongly felt viz., to regulate and protect the organization of trade unions and to provide for arbitration in cases of industrial dispute. The right to strike was unquestioned, but members of trade unions had no legal protection against civil liability arising out of action connected with a strike. To induce a worker to refuse to perform his duties and thus to commit a breach of the contract of service, was, under the existing law, an offence, and in 1920, there was a famous case in which the law was thus enforced. Legislation was, therefore, undertaken in 1925, to provide for the growth of trade unions on right lines. It evoked a wide divergence of opinion, and while labour would not be satisfied with a half-hearted measure, capital regarded the whole thing as a dangerous movement. Two questions were keenly debated : should the registration of unions he compulsory or voluntary? And should union funds be allowed to be utilized for political ends? Opinion ultimately veered to the view that registration should not be made compulsory. It was provided by the Act that a separate fund may be constituted from optional contributions and may be utilised for expenditure on specified objects for the promotion of the civil and political interests of members of trade unions. The Act also provided that the officers of registered unions should, to the extent of one-half, be persons actually engaged in the industry with which a trade union is connected. Immunity from criminal and civil liability is also conceded by the Act, and trade unionists are protected from prosecution for criminal conspiracy where the agreement into which they have entered, is not an agreement to commit an offence. Provision is likewise made for regulating the expenditure of union funds and the audit of the accounts.

Indian legislation does not go as far as the corresponding English law and reflects the undeveloped nature of the trade union movement in this country. Under the latter, if a union decides to establish a political fund all members must subscribe to it unless they give due notice that they do not wish to do so, while under the former, the process is reversed, members desirous of contributing, being allowed, on their expressing a wish to that effect.

The Trade Union Act of 1926 was amended two years later, in order to remove certain doubts and ambiguities with respect to appeal against the registrar. Like 1925, the years 1927 and 1928 were bad years from the point of view of labour unrest and strikes. Bombay witnessed one of the worst strikes in 1928–29 in its cotton mills, and the struggle between the G. I. P. Railway and its workers in 1929–30 was equally bitter. In the former, the millowners wanted to enforce a scheme for standardization of wages, duties and numbers of operatives and framing standing orders regarding conditions of employment. The proposals involved a $7\frac{1}{2}$ per cent. cut in the weavers' wages and though the Bombay Strike Enquiry Committee approved the scheme generally, it did not recommend its immediate application. The Committee, however, felt that in order to avoid the kind of lightning strikes which had become only too common, provision of some machinery for preliminary discussion and an attempt at settlement, had become essential.

Government, as representing the public, is interested in the peaceful settlement of trade disputes, in its own commercial undertakings like the Post Office and the Railways and also in private industries. The Trade Disputes Act was, therefore, passed in 1929 with a view to provide a machinery like a court of inquiry or a board of conciliation, enabling government to intervene in disputes as early as possible. Government is empowered by the Act to set up this machinery of its own accord or on the application of the parties, separately or conjointly. In public utility services, 14 days' notice has to be given before a strike actually breaks out or a lock-out is declared. A strike or lock-out is declared illegal if it has "any object other than the furtherance of a trade dispute within the trade or industry in which the strikers or employers locking out are engaged" or if it is "designed or calculated to inflict severe general and prolonged hardship upon the community and thereby compel the government to take or abstain from taking any particular course of action." It is worth noticing how workers in public utility services receive a treatment different from what is meted out to other workers, but receive no compensating concession.[1] The Act likewise makes short work of "sympathetic" strikes. The

1 See Dr. A. Mukhtar: *Factory Labour in India.*

machinery was employed in the Bombay mill strike. But a Royal Commission was thought necessary to go into the whole question of factory labour, and the results of its inquiry and its recommendations, which are not likely to be made public before 1931, will be awaited with interest. Before closing, we have to refer to one important tendency in the development of the labour movement in India, and it is the influence of extreme forms of socialism on a section of organized workers, which has even caused a split among the leaders. Communism makes an appeal to certain sympathetic but academic minds in all countries, which are carried away by idealism, but its failure everywhere outside Russia to make any impression on practical affairs, is enough to demonstrate its futility as well as its danger to a country like India.

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CHAPTER XVII.

INTEREST AND PROFIT

318. Lending is a Service:—Capital represents wealth which is the excess of production over consumption and therefore results from saving. If all the wealth produced by a community were to be consumed as it became available, economic life and progress would be impossible. By increasing the productivity of labour, capital helps to create a surplus and thus assumes special importance from the point of view of wealth-creation. As an aid to production, it is in request everywhere and it, therefore, commands a price. Those who own capital are in a favourable position because they command a useful, and in modern communities, an indispensable instrument of wealth-acquisition and those who lack it, are prepared to pay a price for it. The capital lent to a needy person may not have been saved by its owner who may have received it as a legacy; and it may not be productively used and may be wasted. But it consists of or can purchase commodities for which a demand exists, and therefore, its possessor legitimately claims remuneration for allowing its use to another person. There may be no real sacrifice or 'abstinence' on the part of the lender, but he does render a real service to the borrower and there is a universal social convention that the loan should be returned with something added to it.[1] Present wealth is undoubtedly more valuable than future wealth, and more of the latter must be given for the control and use of the former, the difference between the two depending upon the varying conditions relating to supply and demand, in a given community at a given time.

It is obvious that the mere act of postponing the use of commodities and of conserving them or of storing money that represents them, will not yield an income. The wealth or the money saved

1 "Interest is paid for the same reason as all other payments are made, because a loan confers a service; there are always people willing to pay interest because a loan will enable them to satisfy their wants".--Henry Clay: Economics.

and set aside, must be lent or invested in order that it may produce a return viz. interest. That is the way in which thrifty individuals or classes are able to earn an income on capital which remains intact. The income of the organizer of an industry, who puts his own capital into the concern, is expected to include remuneration for the amount thus invested just as the capital lent to another industrialist receives a return that may be agreed upon. There is always an element of risk involved in the advance of the money lent or invested, as it may bring in no return and may not be repaid. The greater the risk, the greater is the unwillingness of the person with capital to part with it and therefore the higher is the rate of interest that will be demanded. Interest is the name given to the payment obtained for money invested in a productive enterprise as well as lent for the purchase and use of consumption goods. The owner of capital denies to himself the use of capital during the time it is in the possession and enjoyment of the borrower and wants to be compensated for the act of self-denial. It is marginal utility which ultimately determines the price of the use of capital.

319. Interest :—It is now clear that owners of capital who invest or lend their wealth, are entitled to take out of the reservoir of national income, their share due to them for the services rendered by them to the community. That interest is as legitimate as rent or wages and is a proper remuneration of capital, which is wealth not consumed by the lender and is placed at the disposal of the borrower, for his needs and benefit, is well understood in this country. People know that there is nothing inherently wrong in borrowing if it is resorted to for productive purposes or for occasional domestic requirements or to tide over extraordinary difficulties and that the money-lender, likewise, renders a distinct service and deserves payment for it. We have shown in the first and in this volume how important capital is as a factor in production and how industrial progress in India will be governed by the ease with which capital can be secured by producers of wealth. Capital will not be saved and accumulated unless there is inducement for people to do so. Interest is this inducement and money lenders and banks take it upon them to supply capital.

People who want to provide for the future, save and invest in different ways, e. g. shares and securities. Those among the educated and the intelligent classes, who do not like to take

risks and are anxious for a secure income, invest in government loans or loans floated by public bodies and deposit their money at the postal savings banks from which the rate of interest obtained is low. For the common people, the channels for investment are few and restricted. Money-lending is a troublesome business because it involves risks and litigation. It sometimes brings on social odium, but it is lucrative. Most of the ordinary money-lending is on the security of moveable and immoveable property. Mortgaging of lands and houses is extensively done by persons in difficulties, and several sowkars lend on mortgage with the view ultimately to acquire the mortgaged property by taking advantage of the inability of the debtors to repay. Lending on the security of jewellery is regarded as the safest kind of transaction because the object pawned does not deteriorate and can be easily converted into cash. And people very often turn their savings into jewellery with the express object of having with them a security to offer for loans. Village sowkars, as a matter of convenience, take interest from cultivators in the form of grain; and the harvesting season is the time for the collection of the amounts due. They are thus able to ensure the food supply of the family and to obtain it at comparatively low prices.

The remuneration of capital in India is high, and it is notorious that rates of interest are usurious. There is never a uniform rate of interest anywhere, much less in a country like India, though at a given time and place, there is an interest rate for different species of capital, depending upon security, amount and other considerations. In western countries, the rate steadily went on falling for years till at last it was raised by the enormous demand the War made on capital throughout the world. Where competition has free play and there are banking facilities, variations in the rate of interest are small; but in the absence of these conditions, it varies widely and generally rules very high. It is also high where the supply of capital is inadequate, and millions of British capital have thus been attracted to the Colonies and to foreign countries. As we shall presently show, usury is largely practised in India; and though there is a strong popular feeling against unconscionable rates of interest, money-lending is extensively done by all classes of people. Some specialise in the business, but the number of amateurish lenders of money is not small. Big banking houses and sowkars' families are held in

high esteem and the business of money-lending has great scope in India. Those who are prepared to take the risks and to undergo the trouble and the worry involved in the realization of interest and the recovery of the capital, play for high stakes, and their loans are often a gamble. Owing to the high prices at which lands are purchased and to the inefficiency of production, the capital invested in land yields a low rate of interest.

320. Rate of Interest :—It appears that for centuries, since ancient times, the average rate of interest in India has been in the neighbourhood of 15 per cent. It has, of course, varied from time to time and from one part of the country to another. Political conditions such as those of war and peace and the state of industry and trade generally influenced the prevailing rate and the particular circumstances of each case caused marked variations. With increasing security of life and property, with the spread of education and the extension of banking facilities, the rate of interest slowly went down. Mr. Datta's inquiry led him to the conclusion that the rate of interest in India was steadily declining. He obsevers:— " The rate of interest on agricultural loans varies widely in different parts of India and even in the same place, according to the credibility of the cultivator or the security offered ; thus in Bengal, it is said to be 36 per cent.; in Eastern Bengal, 37½ to 75 per cent.; in the Central Provinces, anything from 6 to 100 per cent., and in Madras 6 to 36 per cent. It is, therefore, difficult to collect statistics to show whether the rate has increased or decreased. But the general belief is that the rate of interest has been lowered except in some parts where restrictions have been placed by law on alienation of land, thus reducing the value of security. It seems from the evidence collected that this lowering of the rate has been due to increased wealth and a consequent increase in the number of moneylenders who compete with each other in reducing the rate. Co-operative credit societies have also doubtless contributed to these results in places where they have been constituted. "[1]

But as capital is shy in India, it requires a more liberal remuneration than elsewhere. The ordinary producer has no capital of his own and must borrow at uneconomic and ruinous rates of

1 Report on High Prices.

interest. Without a rapid increase in wealth-production, a wide expansion of banking facilities and a rapid spread of education, interest rates are not likely to be appreciably lowered in this country. After all, the current rate of interest is governed by the law of supply and demand, and it will be lowered only if more money is offered for loans. The war made heavy demands on capital, and high rates of interest ruled ; after the restoration of peace the current rate has steadily declined. Before the war, money could be obtained for good security, at 4 to 5 per cent ; but later, 9 to 12 per cent. became the ruling rate for the same loans. The rate of interest on government and other securities steadily went down in India for many years and only the war loans pushed it up. The ten years bonds and long term loans were offered by government at 6 per cent. and more ; and this high rate has had its effect upon the general rate of interest. The decline in the purchasing power of money had a good deal to do with this phenomenon. It will take a long time for the rates to go down again to the pre-war level as they are likely to be kept up by the large demand for industrial capital. In the busy season, the rate for temporary accommodation is high and this rate is always fluctuating. Money-lenders can always command a high return for their capital, and agriculturists, artisans, craftsmen, small traders and other needy people can not borrow without paying a heavy price. There is an element of risk in these transactions, and the borrowers are very needy. Hence the prevalence of usury over almost all parts of the country. The variations in the rates of interest on the loans made by joint stock banks are brought about mainly by the temporary stringency or abundance of money accommodation; and the causes affecting the Hundi rates, have been described in our chapter on banking. Banks themselves take deposits at high rates in the busy season and charge high rates likewise for short term loans. A rise in the bank rate is a symptom of the abnormal demand for money and of the monetary drain anticipated.

321. Hindu Law :—The prejudice against the taking of interest which has prevailed in all countries, is attributable to the fact that before the era of large industries, money and goods were chiefly borrowed by people in difficulties or distress; and to demand a reward from the debtor for his use of the borrowed amount under such circumstances, was naturally regarded as cruel, and therefore,

objectionable. In India the true nature of interest was clearly understood even in remote times and the law attempted to regulate its rate rather than to prohibit it altogether. The distinction between a debt secured by a pledge and one unsecured, was clearly understood, and the Dharma Shastras have laid down definite injunctions on the subject.

Thus Manu says that 'a money-lender may stipulate as an increase of his capital, for the interest allowed by Vasistha, and take monthly the eightieth part of a hundred.'[1] This means a rate of interest of 15 per cent. per annum and is taken as having reference to a debt secured by a pledge. From inscriptions belonging to the second century of the Christian era it is clear that the prevailing rate of interest was between 9 and 12 per cent. The guilds of those times took deposits and paid interest on them at the above rates. In the case of unsecured debts, Manu allows 2 per cent. per mensem, the higher rate being justified by the risk involved, 'for he, who takes two in a hundred becomes not a sinner for gain.' The rate of interest was also to depend upon the caste of the borrower—the lower the caste the higher the rate.

Other law-givers such as Narada,[2] Brihaspati, Vasistha and Yadnavalkya lay down similar rules regarding rates of interest, of which four different kinds are mentioned, including compound interest; and it is stated that besides the general rules, there are special rules according to the local usage of the country where the loan has been made. The highest limit to which interest may be allowed to grow and above which it is not permissible, is double the amount of the principal.[3] A limit of three and even eight times is mentioned as obtaining in certain countries. Varying rates of interest are spoken of as chargeable on gold, grain, cloth &c. Taking of interest on loans made through friendship, is deprecated, unless there is an express agreement on the point; and even without agreement interest is supposed to accrue after six months. Usury is specifically condemned. Manu says :—" Stipulated interest beyond the legal rate, being against (the law) can not be recovered; they call that a usurious way (of lending). The lender is in no

1 The Laws of Manu, VIII, 140.

2 Narada, 1,98.

3 This rule is known even to-day as that of " Dam-duppat."

case entitled to more than five in the hundred." As in western countries, so in India, usury or exhorbitant and extortionate interest has thus always been considered reprehensible, and the State has everywhere endeavoured, by means of legislation, to discourage it. This is clear from the spirit of Hindu law and usage in this respect. Islamic law prohibits usury altogether, and several strict Mahomedans do not take interest even on their deposits in savings banks and on government securities.

322. Usury :—In almost all countries in modern times, the State interposes its authority to protect the borrower from the dangers of the professional money-lender, and the need of such measures is no less urgent here than elsewhere. In 1914, the Government of India issued a circular letter to local governments on the subject of the feasibility of preventing the use of civil courts as an agency for the realisation of usurious demands by money-lenders. The issues raised in the letter were, (1) whether the courts are as a matter of fact at present compelled to give effect to unconscionable contracts and to enforce the payment of inequitable and extortionate demands, (2) whether, if the answer is in the affirmative, this abuse of the authority of the courts has attained such dimensions that it is expedient to take steps to remedy it; and (3) in what manner it can be prevented without engendering consequences more prejudicial to the interests of those concerned than exist at present. The main remedies, the letter went on to state, for the suppression of usury, were perhaps the following :—(1) the fixing of a legal maximum rate of interest recoverable; (2) the determination of a legal maximum amount of interest recoverable, commonly known in India as the rate of Damduppat ; and (3) the bestowal of authority on the courts to go behind a contract, re-open a transaction and reduce the rate of interest to what is thought to be equitable. The third line of action has been embodied in the English Money-lenders' Act of 1900.

The Government of India anticipated and stated the various objections that might be raised against the undertaking of any legislation on these lines. For instance, it was contended that it would interfere with private contract, that it would increase litigation and harass the ordinary operations of trade and that it would be ineffective. There was much force in these objections, and the results of

the operation of the Deccan Agriculturists' Relief Act, have not proved very satisfactory. The Government of India itself wisely observed, in its letter, however, that it would not be right to argue that 'everything is the fault of the money-lender and that the debtor is always a blameless and injured innocent.' Usury laws have been condemned by economists as a useless and undesirable interference with liberty, but this condemnation is based on the assumption that the loans rest upon the equality of business opportunity and the free competition of capital. "Under such conditions," Seligman points out,[1] "usury laws are futile and worse than futile, because they either tend to evasion or become a drag on industry." Where these conditions do not prevail and the lender is in a position to take unfair advantage of the borrower, it is necessary to protect the latter. Laws in France, England, Germany and America, grant such protection to the borrowers, and in a country like India measures of this kind were absolutely necessary. As Gide points out, "it is no more of a contradiction to allow liberty as regards the rate of interest, while punishing those who make a profession of lending at a high rate, than it is to allow consumers the liberty to drink while punishing publicans who supply drunken men."[2] Usury prevails very largely in rural areas and industrial centres, where money-lenders like the Pathans charge anything between 50 and 200 per cent. interest and make a living out of small but extremely remunerative transactions.

323. Usurious Loans Act:—The question of affording relief to debtors in cases of unconscionable bargains between money-lenders and debtors, had been the subject of discussion in India for several years, especially in connection with the operation and the effects of the Deccan Agriculturists Relief Act of 1879. The Indian Contracts Act Amendment Act of 1899 was passed in view of certain recommendations made by a commission appointed to inquire into the working of the above Relief Act. The attention of government was again drawn to the problem by the High Court of Calcutta and there was some discussion about it in 1906. But nothing was done at the time on the ground that circumstances were not favourable to legislation. The question could not, however, finally

1 Principles of Economics.
2 Political Economy.

rest there, and as pointed out above, the Government of India consulted the Local Government in 1914 with regard to legislation for the protection of debtors from extortionate creditors.

The proposal having been received with favour, the Government of India at last brought in a usury bill, based upon the ideas referred to above, before the Supreme Legislative Council in September, 1917. The object of the measure was approved on all hands and the passage of the bill through the Council, was not a difficult matter. The bill, it need not be repeated, was based upon 'the principle of giving the courts authority to go behind a contract, to reopen the transaction, and to reduce the interest to an equitable amount.' It became law on 2nd March, 1918. It has not been much resorted to, however, and it is doubtful what ameliorative effect the Act will produce upon the large class of helpless debtors which exists in India. The needs of the poor borrower are inexorable and he quietly submits to the extortions of the professional money-lender whose trade is not likely to be much affected by the rigours of the law.

The usurer will flourish so long as he secures easy victims; and no law, however elaborate, will suppress him. The ignorant, the needy, the extravagant and the unfortunate are the people on whom he fastens and fattens. He has risks to run as he deals with persons who have little security. The public must be protected from these harpies but the most effective method of overcoming the evil is that of spreading education, teaching thrift and providing means for borrowing at reasonable rates of interest. The classes who save and lend, must receive due remuneration for their trouble and sacrifice. The remuneration need not, however, be exhorbitant, and its rate will decline with the increase in the supply of loanable capital. Well-organized banking, co-operative and joint stock, will go a long way in bringing down the rates of interest and to emancipate the poor and helpless classes of workers, agricultural or otherwise. It will, at the same time, provide facilities to those who will save, to earn a secure income from their savings.

324. The Position and Prospects :—Though there is at any given time and at any given place, a bank rate and a market rate of interest, and though there is a relation between them, rates of interest vary with different conditions

in the same community and in the same locality. The current market rate changes with the supply of and demand for ready money and accommodation, while the village sowkar's rate is hardly affected by these changes. Co-operative societies have brought down the rural rate of interest to some extent, though their own rate is high in some Provinces, e. g. Bengal; but the bania is still able to dictate his own terms in the village and the town. The thriftless, the needy, the ignorant and the poor will pay any rate and submit to any conditions imposed upon them by the lender of money and the Kabuli sowkar still flourishes in the country. The prospect of earning an easy and comfortable living is very tempting, especially when good security e. g. gold, land and house property, is forthcoming. The business of the sowkar is thus eminently attractive and is widely practised both as a regular source of income and as a supplementary occupation. It, however, entails a great amount of risk and trouble. The borrower is not punctual in paying interest or repaying the debt, and prolonged and costly litigation has to be resorted to. The sowkar's business has become a specialized art, success in which requires the possession of certain qualities; and amateurs often come to grief when they dabble in such affairs. Compensation for the risk and trouble is sought in a higher rate of interest charged.

Officials retiring from service and business men wishing to live upon independant incomes, invest their savings in government securities and industrial and commercial enterprises. Those who seek a steady and secure income or want to provide for their children, become "rentiers" and invest in the loans of the State and of other public bodies like the Bombay Corporation and the Port Trusts. This method of earning a safe and steady income has been peculiarly popular in India and is suitable for endowments of charities. When before the last great war, remunerative outlets for investment were few and money was generally easy, the rate of interest for government securities was low and had been progressively reduced. Crores of rupees have been locked up in the 3 and the 3½ per cent. government paper, and even to-day, the investments in the latter amount to Rs. 100 crores. During the war and after it, government has had to borrow heavily in India, and this increased demand for the savings of the public has raised the rate of interest. Loans of the State at 6 per cent. free of income tax, have had their effect upon

the general rate of interest. Depreciation of money, that is, a diminution in its purchasing power, in effect, keeps the purchasing capacity of incomes from interest where it was. The rate of interest on government loans is being lowered gradually and has already come down to 4½ per cent. The market price of 3 and 3½ per cent. government securities has declined in sympathy with the higher level of the current rate of interest and the holders of such securities can not sell them to realize cash. The price has been slowly rising in sympathy with the decrease in the current market rate of interest. That paper was not redeemable and was intended only to yield a secure income from year to year.

The prices of industrial shares are governed in the main by the present and the prospective prosperity or otherwise of the concerns and are worked out on the basis of the current rates of interest. Take, for example, the share of a cotton mill in Bombay. The price quotations of its shares on the exchange will be found to be governed by the yield of its dividend last declared and the market rate of interest prevailing at the time. The original price of the shares of the Swadeshi Mill, for instance, and its market quotation on 15th August, 1922 were respectively Rs. 500 and Rs. 5,000, the dividend paid for the last half-year being Rs. 300 per share. The quotation for the Sholapur Mill on the same date was Rs. 20,000 and the original value of the share was Rs. 1,000, the dividend paid for the previous six months being Rs. 1,300. The profits of the holders of shares who had purchased at the old values and at comparatively low prices when the dividends were not exceptionally high, were enormous. Thus the profit of Rs. 1,300 on an investment of Rs. 1,000 in the case of the Sholapur Mill was nothing but fabulous; and equally fabulous was the profit made on the sale of these shares at the high prices ruling in the market. But for purchasers in the market, the rate of interest anticipated was 6 or 6½ per cent. and, therefore, the price of the share for them was Rs. 20,000.

What amount or share out of the total national dividend, falls to the lot of those who provide capital for purposes of production and consumption, and what is precisely the income of the capitalist classes, it is extremely difficult to estimate. This income is often mixed up with earnings of another character and interest is likewise obtained in various forms, e. g. premia, increased prices of commodities, personal services &c. From enquiries which have been

made into agricultural conditions in the different Provinces, it appears to be a safe estimate to put the aggregate indebtedness of the rural population at Rs. 30 to Rs. 40 per head or Rs. 25 per acre of land under cultivation. The total figure for the whole of British India will thus be about Rs. 750 crores. If the average rate of interest be taken at 20 per cent., about 150 crores are annually appropriated by the rural capitalist and money-lending classes. There is besides the debt of the State and of public bodies and the debt connected with urban trade and industries. It will not be wide of the mark, therefore, to conclude that income represented by interest is about one-tenth of the total national dividend. But this amount is very unevenly distributed, and is divided among different types of lenders of capital who are shroffs, professional money lenders in urban and rural areas, banks, dalals and even landholders and members of the ordinary middle and lower middle classes. This aspect of the subject has been already dealt with above and in our chapters on banking and co-operation and need not be further pursued here. It is, however, clear that a very large slice of the income of the people goes into the pockets of a small class of money-lenders whose number is, however, large in relation to the demand for their services and who have to charge high rates of interest to make a living on limited amounts of capital. A reduction of this income is necessary for the healthy growth of industries and trade and for the amelioration of the condition of the working and other poorer classes, and it can be accomplished only by means of improved and organized banking.

325. Profit:—The last participant in the national dividend is the person who brings together the factors of wealth-production and sets them in operation. Profit is, therefore, the remuneration of the entrepreneur or organiser of an industry. It is often times confused with interest and the ordinary wages of labour. Profit is, however, excess of the selling price over cost of production which includes wages, interest on capital and rent paid for the use of land. The 'marginal' producer is just able to meet this cost, but the producer whose cost is less, derives a profit. In profit, as it is generally understood, there is always an element of wages or interest; but pure profits, in a state of competition, depend upon varying prices and costs. In conditions of monopoly, the excess of incomings over outlay, may be unaccountably large and have no relation to cost,

trouble or risk involved in producation and supply. The size and the nature of the demand set limits to the profits under these circumstances. A producer may himself contribute all the factors of production, and the value of his output will contain the elements of remuneration for all of them. It is not, therefore, easy to distinguish the profits of the common cultivator and the artisan who supply their own labour and enterprise.

The profits of Indian cultivators are, of course, regulated by the prices of agricultural products and the peculiar conditions as to costs under which they produce. In times of scarcity, for example, the prevalent high prices favour cultivators in certain localities while their neighbours may be losers. The unsatisfactory conditions of the American cotton crop will thus send up the prices of the Indian staple but in this case it is the middleman who is more likely to get the advantage than the cultivator, though the latter does not fail to derive some benefit. Here luck or chance plays an important part; but continuous profits are the result of more or less permanent advantages and favouring circumstances, which are, however, discounted by competition. The advantage of care and diligence, of good soil, cheap credit, irrigational facilities, proximity to markets, utilization of improved manures and implements are these factors. But the profits will diminish or vanish as these advantages are shared by other cultivators. Increased wages of labour and high prices of clothing and other necessaries of life which have to be purchased, will again, increase the costs of production and reduce profits. This does not make improvements meaningless because what is lost in falling prices, is gained in a larger output. And here we are speaking only of pure profits. As regards manufactures, a craftsman who is reputed to be ingenious or honest or skilful, is able to procure larger profits than his competitors. The above remarks apply to trade also.

Profit in this sense of a differential gain, like rent, depends upon certain peculiar advantages, vanishing when these favourable conditions vanish. It is for this reason said that profit may be reduced to zero and yet an industry may continue to be carried on. The opening up of a part of the country by a railway or the establishment of a new market in the vicinity, has made agriculture more profitable in certain localities while that advantage is denied to less fortunate tracts in the interior. But ordinary profit which

is nothing but a reward for the trouble and risk of management, becomes a part of the cost of production, and however small it may be, it must be earned by all in order that they may carry on their industries. When the elements of rent, interest and wages are excluded, profit is the remuneration for the work of organization and management. It is possible to find out the residue after the shares of these factors are deducted from the price obtained for the produce and it may often be nil. A cultivator who takes a farm on lease, for instance, pays rent, wages and interest and retains an amount in his hands which is larger than what he would have obtained if he had worked for another as a mere hired labourer ; and that amount is his profit. If no such surplus is left, he must be said to have earned no profits but obtained cnly ordinary wages. Where it is not the result of fortuitous circumstances, profits will be the reward for inventiveness, superior enterprise and efficient management.

326. Agricultural Profits :—Agircultural profits were comparatively steady when different parts of the country were isolated from one another and from the outside world, being disturbed only by scarcity or famine. There is a cycle of good and bad years in agriculture in most parts of India, where the supply of water is not secure, and profits and losses alternate. Losses have to be carried over from bad to good years and the average profit is small or is negligible except in cases where weather conditions are normally satisfactory and there is an assured market for the produce. When provinces and districts were isolated from one another, this disparity was remarkable. But now the districts and provinces of India have been linked to one another and to foreign countires by railways and steamers, and competition also plays a more important part than before in the determination of profits. The demand for cotton, for example, in foreign as well as in local markets, acts upon the price of the Indian staple, and the profits immediately go up with rising prices though they may be partially intercepted by middlemen as pointed out above, and may not always reach the actual producers. While, therefore, the cultivator in India may get out of the soil just enough to maintain himself and his family after meeting the cost of the cultivation, consisting of interest on capital and revenue or rent and so forth, the profit will be only the wages of labour. What a cultivator working on dry land may earn per acre will depend upon the

extent of his field and the cost and the selling prices; irrigated land may yield him twice as much. In certain circumstances, therefore, some margin will be left to him, which will be his profit.

The profits of the cultivator will, normally speaking, increase if he can utilize the factors of production more economically. If he makes the most of the materials and implements he possesses and bestows all his energies and care upon the business, he will be able to extract a larger output from the soil. The items of interest and rent take a heavy toll of the produce of agriculture and the surplus tends to become small. An adequate supply of cheap capital combined with the enterprize and managing capacity of the farmer, must yield substantial profits. Improved implements, good seed and manures and advanced methods of cultivating and marketing, are factors which are calculated to make intensive farming profitable. In dry farming much has to be left to chance and the returns are precarious. But even there, careful and judicious management does not go without its proper reward.

A farmer who possesses a large block of land enjoying the benefit of a well or an irrigational canal and who has a stock of plough cattle as well as capital for seed and manure, is able to make good profit and is well off. In such intensive farming, the cost of cultivation is considerable, but the profit is also good. But usually the cultivator is just able to maintain himself and his family with their labour, and the income from the land owned or leased must be supplemented by wages earned elsewhere and in other ways.[1] Agricultural profit worthy of the name is obtained by substantial land-holders and particularly on irrigated land, for instance, where sugar-cane and garden and commercial crops like tobacco, fruit, vegetable, oil seeds and cotton, are grown.[2] Owing to minute sub-

1 See Dr. Mann's Life and Labour in a Deccan Village.

2 "How very large the margin of profit may thus become I can illustrate from my own experience with regard to the land round the city of Poona. Ten years ago, this land produced only a poor and uncertain crop of millets worth perhaps Rs. 5 or Rs. 10 an acre. Now the same land is covered from year to year with a magnificent crop of sugarcane, and when I left Poona the other day it was being sold as it stood on the ground for about Rs. 500 an acre. By this transformation the raiyat, from being a wretched starveling, ever on the borders of famine, becomes a substantial yeoman eager for further improvements and ready to pay for all the accommodation he requires."—Sir. W. Wedderburn in a paper on Agricultural Banks in India read before the Manchester Chamber of Commerce, in 1883.

division of land and want of capital, the profits of cultivation are usually very small. These facts are brought out in the inquiries which have been recently made into the family budgets of cultivators in different parts of the country. Here agriculture is not a business in the proper sense of the word, and there is no regular profit in it.

If profit is the reward for enterprise and efficient management, the farmer must have at his disposal the means of earning an income in that form. We have to recall here the unfavourable features of the common Indian rayat's position in this respect. The uneconomic smallness of the holding of the cultivating proprietor or tenant farmer, brought about by repeated subdivision and dispersion, renders remunerative organization and management impossible, and profits may ultimately be found to be equivalent to or less than current wages. It is a common experience in many parts of the country that agriculture does not yield even the lowest market rate of interest by way of profit. Consolidation of holdings and co-operative cultivation are calculated to improve the position. Otherwise, farming can not be organized and managed as a business. It becomes a supplementary industry ; or rather, other occupations and industries supplement agriculture, and any profit that may accrue, is not agricultural profit in the true sense. Agriculture must, in such cases, be regarded as a losing activity and is carried on for non-economic reasons. At any rate, it can not be an independent enterprise remunerative by itself. That capitalist and absentee landlords fail to secure profit while the rayat scores apparent success, is a phenomenon which merits reflection in this connection. On a holding of decent size and average fertility, profit will vary, in a normal year, from Rs. 10 to 50 per acre, depending as it will on the kind of crop raised and the capital invested.

327. Industrial Profits :—The above remarks apply *mutatis mutandis* to the ordinary artisan or craftsman also. Those engaged in domestic industries, the autonomous workers, will normally be able to get just enough to maintain themselves, that is, wages, unless the demand for their products increases and enhances prices or their costs of production are reduced. As we have shown in a preceding chapter, they may not be able even to get these wages

and may have to give up their callings.[1] Take shoe-making as an example. The ordinary shoe-maker's family lives from hand to mouth and there is no profit in the industry. But an enterprising shoemaker now goes about and secures orders for shoes and boots of various types and sets a number of skilled operatives to work for him. Such a person is able to earn a clear profit. Organization of industry in this way yields fair profits also in other occupations and trades. Conditions created by the War, favoured several classes of producers, who, in normal times, could just make a living or led precarious lives, and they enjoyed a temporary spell of prosperity; but the profits of these industries disappeared with the cessation of the war and unless economies are introduced in management or prices remain at a sufficiently high level, they will barely remunerate the labour of the workers. Almost all the members of the family of a craftsman will work at a home industry, and the normal profits there, are nothing more than the wages of management. But the possession of special skill and the reputation acquired through the largeness of the number of satisfied customers, yield profits to a few prominent craftsmen.

In the case of an autonomous producer, a master craftsman employing hired labour, the remuneration of management is substantial and can be easily distinguished. That is not possible in the case of a small artisan working by himself or with the help of the members of his family, though of course, the element of profit may be present even there. Several such craftsmen and artisans, rise from the position of humble wage-earners and become employers of labour and earn profits from the industries organized by them. They save and borrow capital and are able to clear a margin after paying interest and wages. Many such builders, bidimakers, carpenters, weavers, shoemakers, tailors, contractors, printers, bookbinders, dairymen and shop-keepers may be seen every where. And given the necessary ambition and enterprise, there is much scope for profit even in small and indigenous industries. The use of machinery, improved implements and tools and of new methods, enables a

1 "Taking India, as a whole, although there has been an increase in industrial prosperity and development in the period between the censuses of 1901 and 1911, competition with imported articles and the products of factories, organized on the latest methods and worked by machinery, have ruined many of the handicrafts, especially the handloom industry and compelled people to leave their ancestral vocations for other means of livelihood, notably agriculture."—K. L. Datta: Report on High Prices.

profit being reaped, and examples of such profit in agricultural and non-agricultural industries, particularly the latter, e. g. flour mills, brick and tile works, cap factories, foundries &c, are common.

The profits of industries conducted on a large scale and on modern lines, have been large enough. Cotton, jute, the tea plantations and the mining and engineering industries as also banking, insurance and export and import trade, have left considerable surpluses which have encouraged the expansion of manufacture. "The number of these is, however, very small. The rise of prices has undoubtedly benefited them in as much as the prices of articles produced by them, have, in most cases, far exceeded the cost of production." When competition is active, the general rate of profit will tend to be uniform and to diminish. Capital will flow into the comparatively more remunerative industry and the level of prices and profits will be brought down. People rush into industries and trades which temporarily yield high profits and help to equalize and reduce the rate of the latter. Competition thus set up results in the elimination of the less fit to live. Customary profits are steady, and particularly so in most rural parts in India, except when the equilibrium between the supply and the demand is disturbed by an economic crisis like a famine or when the high prices ruling in the outside markets reach the country side. The rate of profits in a few industries concerned with luxuries, is extra-ordinarily high e. g. perfumery, though the total turnover is comparatively small.

328. Dividends:—Joint stock companies afford a good oppportunity to persons who have small amounts of capital to invest and who want to share in the profits of the large manufacturing industries. Shareholders receive not only interest upon the money they have put into the industrial or trading concerns, but participate in the profits of organization and management also. The concerns are managed by or are under the surpervision of their representatives, the elected directors; and shareholders are entitled to receive a share in the profits. The holders of 'ordinary' shares are prepared to face the risks of loss in the hope of receiving such dividends normally as will more than make good occasional deficits. They participate in the control of business, and therefore, in profits and losses. Those who hold 'debenture' claims, are the creditors of the company and are content with a fixed rate of inter-

est on their capital, which must be paid before profit is declared. They do not control the management and receive no profits. Holders of 'preference' shares are assured a fixed rate of profit and their claim must be satisfied before a dividend is paid on 'ordinary' shares, though they are not entitled to receive more when the company earns more. The name 'deferred' shares is significant enough. The device of joint stock companies, in this way, enables persons who could not conduct industries themselves to become part proprietors and managers and to share in their profits which are an inducement to capital to flow into productive channels.

The Bombay mill industry reaped a rich harvest of profits when owing to the deficiency of the supply of foreign cloth, the level of the prices of indigenous piece goods rose during the war. But in the post-war years, the profits vanished and there were serious losses. Before that time, in pre-war years, it earned moderate profits as it gradually expanded. How abnormally high profits may be earned by industries which are placed in exceptionally favourable circumstances, may be best illustrated by a reference to the huge amounts raked in by the jute mills during the four years ending in 1918. The amounts of the profits given below are arrived at after deducting the income tax and the supertax paid to government. These huge profits were earned, be it remembered, at a time when raw jute was very cheap and the Bengal cultivators suffered from low prices.

Jute Mill Industry.

Years.	Net Profits. £	Ratio of Net Profits to paid up Capital per cent.
1914	823,000	10
1915	4,661,000	58
1916	6,155,000	75
1917	4,305,000	49
1918	10,57,8000	113

Half-yearly statements of Jute Mill Profits.

Profits including debenture interest.

Year		Rs.	Year		Rs.
1913	...	2,45,97,553	1919	...	11,64,53,696
1914	...	96,18,649	1920	...	12,64,82,666
1915	...	4,29,48,960	1921	...	4,95,86,033
1916	...	6,48,71,541	1922	...	3,58,35,863
1917	...	4,23,92,573	1923	...	4,95,33,808
1918	...	12,29,25,767	1924	...	6,06,72,619

High rates of dividends were similarly paid in several other industries e. g. paper mills. Shareholders pressed for the distribution of as large amounts of profits as possible. Money which would have proved useful in overhauling old or purchasing new machinery and in providing efficient equipment, was distributed among shareholders who wanted to make hay while the sun of prosperity shone. And in several industries the time of depression and losses soon came. There are, of course, ups and downs in the condition of these industries, and in calculating profits we have to take the average of a few years. The scale of profit in the case of the cotton industry, for example, is regulated by the stocks of piece goods in the market, the price of raw cotton, the supply of coal and so forth. But on the whole, in industries carried on with the assistance of machinery and on a large scale, the rate of profit is sufficiently high. The shares of joint stock companies are quoted at high figures and the share-holders of such concerns, large and small, participate in the industrial prosperity. The market quotations go up and down with speculation, but at bottom they are based upon the profits earned by companies and the market rate of interest which is a constant regulator. The depression which followed the post-war boom, darkened the outlook for several important industries which ceased to pay dividends to share-holders *e. g.* steel, paper, cement, cotton &c. The new mills and factories which were seen rising on every side, the gins and presses and the oil, leather, woollen and flour mills as also sugar-cane crushers which were set up, were an indication of the attractive profits that were expected in these concerns. It was also evidence of the diversion of industrial effort from one direction viz. the old, to others, the modern type of manufactures. Cotton mills were reported to be making huge profits in the midst of the general post-war economic depression. The industry was stated to have earned a profit 16 crores in 1920 and 15 crores in 1921, on a capital of Rs. 16 crores. Joint Stock banks also showed substantial profits. In 1924 and 1925, however, the condition of the industry was very bad and there were heavy losses, only a few mills being able to keep their heads above water. The situation remained bad upto 1930 till special tariff protection was granted to the industry, though up-country mills were generally better off.

The following figures are taken from an estimate of the profits of the Bombay mill industry :—

Year	Paid-up Capital in lakhs of Rs.	Profit in lakhs	Year	Paid-up Capital in lakhs of Rs.	Profit in lakhs
1910	6,40	60	1919	13,10	13,06
1911	6,80	52	1920	16,10	16,58
1912	6,80	2,60	1921	16,60	15,39
1913	7,30	1,82	1922	18,90	7,27
1914	7,80	89			

The Textile Tariff Board gives the following relevant statistics which include added figures for later years :—

(In crores of Rs.)

Year	Paid-up Capital	Original Cost of buildings &c.	Net profit or loss	Percentage of dividends to paid-up capital
1917	7·65	17·98	3·02	22·2
1920	16·98	33·50	10·10	35·2
1921	17·83	38·08	8·46	30·0
1924	19·28	46·76	–2·42	3.2
1925	19·20	46·72	–2·87	2·2
1926	18·95	45·74	–1·92	—
1927	18·08	44·42	– ·11	—
1928	17·15	42·99	–2·95	—

329. Steel, Coal and Tea:—While it is not practicable to ascertain the profits earned in petty cultivation, small farming and the domestic industries, with any pretence to accuracy, the profits actually obtained in the organized industries are published with full particulars for the information of shareholders of companies. The profits of the cotton and jute industries have been referred to above. Three other typical industries may be taken here to illustrate the subject further, viz. steel, coal and tea. While prices were high, the Tata Iron and Steel Company distributed handsome profits among its shareholders, and the market prices of its shares of different classes soared to great heights. In 1917–18, a sum of Rs. 54 lakhs was paid as dividend on a capital of Rs. $3\frac{1}{2}$ crores, and in 1920–21, on a capital of Rs. $10\frac{1}{2}$ crores, Rs. 53 lakhs were distributed, the ordinary share-holders receiving 18 per cent. and the holders of deferred shares 202 per cent. Prices of steel thereafter declined and the costs remained high, with the result that even preference shares could not be given any dividend. Even in spite of the protection granted to the industry, the Tata Company could barely pay part of the arrears

of the dividend on preference shares in 1924–25; and ordinary shareholders had to be left out in the cold as in the year previous. Prices of steel shares were, therefore, enormously depressed. The industry which is identical to-day with the Tata Company, appeared to be overcapitalized and even in spite of State bounties, was unable to pay a dividend on the ordinary shares. Reduction of ordinary capital was, therefore, proposed as a remedy. Protection has been, however, continued to the industry, and its shares have been looking up, though the ordinary share holders have failed to receive the expected returns.

As there are a number of privately owned coal mines it is difficult to estimate correctly the aggregate capital employed in the industry. Eight of the joint stock companies paid an average dividend of 15 to 90 per cent. in the five years 1911–15 and 30 to 110 per cent. during the quinquennium 1916–20. It is, however, worth bearing in mind that in 1923, out of 125 coal companies in the share list, with a paid up capital of Rs. 8·7 crores, 57 declared no dividends. One company paid 150 per cent., two 85 per cent., one 65 per cent., two 60 per cent., one 57⅓ per cent., six between 50 and 37½ per cent. and the remainder declared dividends ranging from 2½ to 30 per cent. Similar figures may be quoted for later years, and it should be noted that the coal industry has been recently passing through a state of depression. The total capital invested in the Indian tea industry is about Rs. 48 crores, of which joint stock companies registered in India account for 11¾ crores of rupees. Of 132 companies of the latter class, concerning which particulars were available, 88 companies declared dividends for 1922, amounting to 33·2 per cent. on their aggregate capital of Rs. 3¼ crores. In 1923, 106 companies declared dividends on their total capital of Rs. 3¾ crores, amounting to 38 per cent. The corresponding figures for 1928 for 95 compaines, were 23 per cent. on an aggregate capital of Rs. 3·82 crores. "The value in March for Rs. 100 of joint stock capital as calculated on the prices of shares quoted in the Calcutta share market was Rs. 144 in 1922 for 122 companies, Rs. 182 in 1923 for 119 companies and Rs. 260 in 1924 for 123 companies."[1] The figures for later years are: Rs. 285 per Rs. 100 joint stock capital in 1927 for 136 companies, Rs. 332 in 1928 for

1 Indian Trade Journal.

134 companies and Rs. 303 in 1929 for 135 companies. The tea industry has been passing through a state of comparative prosperity during the past few years. In the case of this and many other large industries, it will, of course, be borne in mind that the profits accruing from them are earned by the foreign capital invested in them and are consequently not a part of the real national dividend.

The following information regarding the dividends earned by and the current prices of the shares of a few typical joint stock companies during October, 1927, will be found interesting :—

Company		Original Value of Share Rs.	Dividend last paid	Present Market Value Rs.
Pachora-Jamner	...	100	5%	89
Dhond-Baramati Railway Co.	...	100	6%	102
Andhra Valley Electric (Ordinary share)	...	1,000	7%	805
Tata Hydro (Preference)	...	1,000	30%	1035
Indian Cotton (Press)	...	125	17½ Rs.	215
Bombay Dyeing	...	250	25 ,,	976
Laxmi Cotton Mill	...	1,000	300 ,,	6550
Sholapur Mill	...	1,000	325 ,,	8,200
Tata Iron and Steel (Ordinary)	...	75	1 %	53
Kemp	...	200	15 ,,	200
Central Co-operative Bank	...	50	8 %	68
Imperial Bank	...	500	16 %	1,445

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CHAPTER XVIII.

TAXATION

330. What is a Tax?:—It now remains to consider the claims of a special sharer in the national dividend viz. the State. The part taken by the State in wealth-creation is indirect and, in certain exceptional cases, also direct. The State is not a parasite which receives an income that it does not earn. The services it renders by providing for defence and the maintenance of order, the making and enforcing of laws, and for the promotion of education and public health, are of very high value; and wealth-production would be difficult and inefficient, if not impossible, without them. It is the members of the organized community who contribute to the expenses of government in whom its sovereignty is, for that purpose, vested; and the latter may also receive rent and profits, in its capacity of landlord or industrial organizer. The methods of securing revenue have varied from time to time and from country to country; and popular control over the expenditure of national revenue, depends upon political liberty and constitutional rights enjoyed by the people. The sources of the State's revenue are, however, strictly limited, and the differences which distinguish the systems of taxation and revenue have been seldom fundamental, though varying political, social and economic conditions largely determine the manner in which the citizens will be called upon to contribute towards the expenses of government and in which the burden will be distributed among classes.

The right of the ruler to take a share of the income of each subject and to levy imposts of various kinds on different forms of wealth produced by the people, has always been recognized in India as elsewhere. A good ruler was expected to levy moderate taxes so that they might not press heavily upon his subjects; but their range was usually very wide though their individual productivity was unequal, and in the majority of cases, small. The ancient law-givers of India lay down what shares the king may take and describe the duty the people owe him to pay the taxes. The words, 'duty' 'aid' &c. used in England to signify the contributions taken

by the king from the people, are suggestive in this respect.[1] In pre-British times, cesses and fees, as well as direct and indirect taxes, were only too well-known in India; and they were all levied on a well-defined and regulated system. Some of the so-called taxes are merely fees or prices paid for specific services rendered by the State or the public powers. In reality there is no idea of a *quid pro quo*, or of direct exchange of services between government and people, involved in taxation; and their membership of society imposes upon people the duty of contributing regularly towards the expenses of the State. The science of finance is a recent growth and the principles of taxation have been steadily evolved. Principles of equity, faculty or ability or benefit derived and equality of sacrifice, have been developed; and the statesman is expected to weigh carefully the social, economic and political effects of the taxes he imposes. A tax has been defined as "a compulsory contribution of the wealth of a person or body of persons for services rendered by the public powers".[2] An attempt is, of course, made to assess the individual's contribution on the basis of the degree of his ability to pay measured by his income, and to exact, as far as practicable, an equal amount of sacrifice from all. Taxation is also used as indirect means to promote certain ends which apparently lie out of the province of the taxing authority, such as correcting the inequalities of wealth-distribution and the promotion of healthy consumption. The State normally determines each year how much it will require for its expenditure and distributes the amount among various forms of taxation. In times of emergency it borrows to cover its expenditure that can not be met out of taxation; and normally secures a part of its revenue from its property and industrial and commercial undertakings. There is a growing tendency to weigh the effects that taxes are likely to produce upon the different classes in the community who must be treated fairly and justly with reference to the burden imposed on them. And their political, social and economic bearings are daily growing in importance. Existing systems of taxation in most countries are, however, legacies of the past and can be altered and improved in the light of developed economic theory only by slow stages.

331. Indigenous Tax-System:—From time immemorial, rulers in India have regularly taken from their subjects contri-

1 See Seligman: Essays in Taxation.

2 Bastable: Public Finance.

butions of wealth or services for the maintenance of themselves and their governments. The people were made to pay in a variety of ways; and while the payment of taxes was acknowledged as a duty in view of the benefits derived from the functions performed by the government, onerous impositions were condemned as tyrannical. Moderation of incidence was a characteristic feature of a good system of taxation. Manu says—"After due consideration the king shall always fix in his realm the duties and taxes in such a a manner that both he himself and the man who does the work receive (their due) reward."[1] His idea as to the method of tapping the people's wealth, is expressed thus :—"As the leech, the calf and the bee take their food little by little, even so must the king draw from his realm moderate annual taxes." The importance of moderate taxation is brought out in the following :—" Let him not cut up his own root (by levying no taxes), nor the root of other (men), by excessive greed, for by cutting up his own root (or theirs), he makes himself or them wretched."[2]

The king must himself live in becoming dignity, maintain his army and his civil officials to protect the people, preserve peace and order and promote the well-being of the subjects. He, therefore, shared in the wealth produced by the different classes of the population and distributed his demand among them according to their occupations and capacity. We find from the accounts of ancient king-craft that taxes imposed upon different forms of wealth and different classes of people are distinguished and personal services are exacted from mechanics and artisans. A fiftieth part of the increments of cattle and gold and the eighth, sixth or twelfth part of crops is allowed by Manu. Heavier taxes are justified by the exceptional needs of the ruler *e. g.* war. Proceeds of regular taxes are clearly distinguished from the income from royal lands, forests and other property. Kautilya gives a formidable list of the sources of the king's revenue and is anxious to expand and conserve them. This system was handed down to later periods of Indian history, and Hindu and Mahomeden rulers had a comprehensive system of taxation into whose het cultivators, traders, artisans, craftsmen, pro-

1 यथा फलेन युज्येत राजा कर्ताच कर्मणाम् ।
नथा वेक्ष्य नृपो राष्ट्रे कल्पयेत् सततं करान् ॥

2 Manu, VIII 131, VIII 133. See also the Author's "Dawn of Modern Finance in India".

fessional men were all caught; and excise, customs and transit duties as well as taxes on acts, transactions, commodities and consumption were a regular feature of the system.

The Moguls and the Marathas essentially followed the same fiscal practice and their assessments and collections were animated by the two-fold principle that the government must draw from the people a sufficient revenue through different sources and that fiscal arrangements must be devised in such a way that they might not prove oppressive to the taxpayers while they allowed none to escape, except those specifically exempted. The right of the State to levy taxes upon all classes of people except a few favoured individuals or sections of the community, was rigorously enforced but exemptions and deductions were liberally allowed in cases where the incidence was calculated to prove unfair or oppressive. Abul Fazl makes the following observation regarding the connection between national prosperity and the fiscal demands of the State:—"But the success of these operations (corporeal or intellectual labour on the part of different ranks of people put forth for recruiting animal strength), which tend to the ease and comfort of every condition of life depends upon the justice of monarchs, and the integrity and ability of their ministers, for every country has something peculiar to itself......So that it behoveth the officers of government, in their respective districts, to attend to every case of those circumstances, that the demands of the state may be fixed accordingly."[1] That the king's demand for contributions must be satisfied at any cost, was a principle universally admitted by the people and systematically enforced by the rulers. It can not, of course, be pretended that the maxims of Manu were always strictly observed and that the taxgatherer was uniformly moderate or considerate. There was, however, great elasticity about the system, and except under tyrannous rule or in times of political confusion, there were safeguards against oppressive and arbitrary exactions.

332. Transition:—The government of the East India Company succeeded to this indigenous system of taxation above described; but it took the British government more than three generations to evolve order out of the chaos which prevailed in the finances of the country and to correct the abuses which had found their way into the system. Some of the important taxes were farmed out; and petty

1 Ayeen Akberi.

cesses were numerous and oppressive. Commodities, actions, production, sale, consumption were all taxed and the system had become harrassing. The impositions on the people were frequently feudal in principle and working. The British government slowly abandoned the petty exactions and concentrated upon the bigger sources of revenue *e. g.* the land tax and the salt and opium monopoly. In several parts of the country the people, however, continued to pay numerous petty taxes; and Sir H. Frere stated that he found more than 60 separate and distinct taxes of the nature described above still levied in Poona City alone, when he was directed to inquire into them in 1836. The more important taxes and other sources of revenue, however, continued to be the land tax, the opium andsalt monopolies of the State and the customs and transit duties. With the extension of territory, improvement of the means of communication and the establishment of peace after the Mutiny, the financial resources of government steadily expanded.[1] With each revision settlement, the land tax was enhanced and the excise brought in increased receipts. As the fiscal arrangements developed, the revenue of the Indian government was made up of different elements: (1) income from its own property, lands, forests, railways leased out to companies, royalties, tributes from Indian States etc., (2) income from its commercial undertakings like railways directly managed by the State, canals, the Post Office, monopolies of salt, opium &c. and (3) taxation proper viz. contributions levied upon the people (i) directly, like the land tax and the income tax and (ii) indirectly, like taxes upon commodites *e. g.* customs and excise duties and upon actions like stamp and registration duties. In India, there have been, for years, two taxing authorities, the Government of India and the local bodies and now the power of taxation has been conferred upon the Provincial Governments also. The revenues of the latter have been comparatively small and the bulk of the taxation has been imposed by the Government of India, and its revenues have been supplemented by its share in the provincial revenues. The Provincial Governments have recently acquired power of independent taxation, and certain sources of revenue have been definitely assigned to them so as to be under their complete control.

1—For the pre-Mutiny state of finance read the Author's "Dawn of Modern Finance in India."

One striking feature of the Indian tax system is the comparatively large proportion the land tax used to bear to the total State revenue. At one time it was fully one-half of the total; only twenty-five years ago it was 31 per cent. Now it is about 15 per cent. With the growth of industries and trade and the increase in the manufacturing and commercial activities of the people, this ratio has steadily declined, and the contribution of the other taxes to the national exchequer has become very much larger than it was a few years ago. In a previous Chapter we have dealt at some length with the subject of income from land and shown that the Indian land revenue is a property tax or a tax on agricultural incomes, that land in India is not, as is often times supposed, the property of the State, and that, therefore, income derived from it can not be regarded as rent taken from tenants. India is said to be one of the most lightly taxed countries in the world, and this statement is mainly based on the assumption that land revenue is a rent. Sir John Strachey,[1] for instance, says:—"The State in India has, at all times, reserved to itself resources which, in other countries, belong to individuals and which render heavy taxation unnecessary. There is certainly no country in the world possessing a civilized Government in which the public burdens are so light." And further:—"In England taxation supplies five-sixths and in India not much more than one-fourth of the public income."

The last statement does not at all hold good, in any case, in recent financial conditions. It must not be forgotten that the Indian system of taxation is the system of a poor and mainly agricultural country and that it has not been under the control of the Indian people. The land tax was the mainstay of the governments in the world before the development of the modern extensive and complicated industrial organization. Formerly land was the only valuable property and index of income, that could be taxed, but now other sources of revenue are much more important and productive. The economic evolution which is taking place in India is bound to move in the same direction, and in the future the proceeds of the land tax will bear a smaller ratio to the total revenue of government than they do at present. The land tax is now an entirely provincial source and will become more and more a local tax. In view of the unsatisfactory economic condition of the Indian

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1 **India, its Administration and Progress.**

people it will be found that the burden of taxation they have to bear, is by no means light.

333. Present System of Taxation:—The very fact that the statement of Sir John Strachey quoted above, viz. that taxation supplies only a small fraction of the total revenue of the Indian government (even conceding that land revenue is not a tax), has become extremely inaccurate, is significant of the radical change which has come over the Indian tax system.[1] With the gradual expansion of foreign and internal trade and of large-scale manufactures, on every side, with the extension and improvement of the means of communication and with the growth of banking, the income tax, customs and excise and stamp duties as also new taxes like amusement and inheritance duties, are sure to assume greater importance. Land revenue is a kind of income or property tax; in Bengal and north Madras, it is a fixed quantity; and other incomes and properties have so far escaped their reasonable burden, though license duties and trade taxes have been tried and a low general income tax had been in existence for over a generation. The Indian tax-system was violently disturbed by the pressure which war expenditure and high prices exercised on it and new taxes were imposed and old imposts were raised in order to enable government to meet the extraordinary demands on the treasury. The government did not, however, break much new ground. It was, nevertheless, thought that the burden of taxation had been thrown on the shoulders of different classes in a hap-hazard fashion and therefore the Todhunter Committee was appointed to investigate the whole problem and to recommend the redistribution of taxation. But little has been done to modify the tax system; and instead of a reduction, the budget for 1930–31 proposed enhancement of the tax-burden. It is, of course, universally agreed that the resources of the different classes of the population must be tapped by a suitable method of taxation that will levy a just and fair contribution on all. The comfort Sir John Strachey administers is, in any case, no comfort at all, because his remark only shows that India is a poor country and that its tax system is unsuited to its needs and changing conditions.

1. Out of a total revenue of 211 crores of the Central and Provincial governments in 1923-24, more than Rs. 100 crores or 50 per cent. was tax revenue if the land tax is excluded and the proportion was 70 per cent. if the latter is included.

Another noteworthy feature is that our customs revenue was, comparatively speaking, very small before the war; and the free-trade conscience of our government and the pressure of British manufacturers and merchants were mainly responsible for this state of things. The war proved a powerful hustler which has forced on government a number of radical fiscal and other changes which would have taken years to commend themselves to them. A high tariff came as a war necessity and remained as an after-war necessity. It is bound to continue for the very reasons for which it was once resisted. Financial centralization and the complete dependence of Provincial Governments on the convenience, whims and the charity of the central government in the matter of taxation and expenditure, constituted another drawback of the Indian system of finance. This defect has now been removed by the complete separation that has been effected between Imperial and Provincial finance though Provincial contributions continued to be a bone of contention and a stumbling block for a few years. Indian finance and taxation have now become federal in character and scope and must be studied from that point of view. Decentralization is the keynote of the Reforms, and it is reflected in the financial as well as in other spheres. A further weakness of the system lies in the poverty of the local bodies whose sources of income are unproductive and inelastic and which are, therefore, not able to undertake those works of public utility which characterise the administration of local authorities in western countries. Attention has, therefore, to be fixed upon national, provincial and local finance as distinguished from :one another for clearness of understanding; and the system must, likewise, be viewed as a whole in order to produce a co-ordinate conception.

Lastly, the power of the purse has not been in the hands of the people and there is no popular control over taxation and expenditure except to a limited extent. Government, therefore, can not and does not levy taxes which it ought, and does not spend those that are levied, in the manner the tax-payers would like them to be spent. The constitutional reforms inaugurated by the passing of the Government of India Act, 1919, conferred this power of taxation and control over expenditure in the Provinces with reference to the 'transferred' departments, on popularly elected legislatures; and the Government of India remained essentially unresponsible in matters financial except for the greater amount of influence the Central Legislature could exercise through the new opportunities which were

provided to it. The nature, the direction and the amount of expenditure have an important bearing upon the whole system of taxation; and the latter will not undergo satisfactory improvement unless and until national expenditure is brought under effective popular control. Constitutional and financial developments are closely connected, and even in Great Britain, public expenditure and taxation are materially influenced by the changes of political parties in power in Parliament, as Conservative and Labour budgets have shown, in recent years. The Simon Commisson inquiry had, therefore, to include the investigation of the financial problem, and Mr. Layton was specially asked to study it and to make recommendations with respect to the changes called for. The claim of the Indian States to a share in the customs and other revenues, the burden of which has to be borne automatically by their subjects, also needs consideration. We shall bring out these points in the course of the present and the next Chapter and shall attempt to show how financial reform of a comprehensive character is needed in India in the interests of the welfare of the people and how it must be brought about with great care and caution.

334. Financial Statistics:—Important changes were effected in the Indian system of taxation as a result of the stress of war conditions; and the expenditure and the revenue of the country have expanded by long strides. Again, the budget of the central government no longer includes provincial figures and the statistics of gross railway revenue and expenditure are now presented in a separate budget. The distribution of revenue and expenditure between the Central and the Provincial governments, was placed upon a new footing as a feature of the constitutional reforms inaugurated in 1921. The system of financial sharing was replaced by the system of independent sources of income for the provincial governments, the latter shouldering the responsibility of making up, for a few years, the resultant deficiency in the central exchequer by proportional contributions.[1] We give below a comparative statement of the revenue and expenditure charged to revenue, of the Government of India, and of provincial governments for the last pre-war year, the year 1920-21, the last year of the old system of accounts, and also for 1923-24, and for 1925-26. We also add a statement show-

1 Read the Author's "Indian Administration" for information on this subject.

ing the growth of revenue and expenditure during the past fifty-five years:—

I

REVENUE.

	1913–14	1920–21	1923–24		1925–26	
			Central.	Provincial.	Central.	Provincial.
Principal Heads :—	Crores of Rs.	Crores of Rs.	Crores of Rs.	Crores of Rs.	Crores of Rs.	Crores of Rs.
Land Revenue ...	32·08	31·97	...	...	...	...
Opium ...	2·43	3·53	2·24	...	4·11	...
Salt ...	5·16	6·76	10·01	...	6·32	...
Stamps ...	7·97	10·95	...	...	...	...
Excise ...	13·34	20·43	...	...	...	...
Customs ...	11·33	31·89	39·69	...	47·77	...
Taxes on Income ...	2·92	22·19	18·23	·26	15.85	·26
Other heads ...	5·04	7.54	2·28	72·77	2·12	75·62
Total Principal Heads	80·59	135·26	74·48	73·03	76·74	75·88
Interest ...	2·02	4·30	3·16	1·58	4·21	2·34
Posts and Telegraphs ...	5·39	9·62	·96	...	·86	...
Currency, Mint, Exchange &c.	·50	·73	3·12	...	4·63	...
Receipts by Civil Departments	2·11	3·55	·68	3·44	·89	3·58
Miscellaneous ...	1·15	20·30	·94	1·86	·54	2·03
Railways : Net Receipts ...	26 43	25·01	32·69	·31	34·40	·03
Irrigation ...	7 06	8·79	·10	7·06	·12	7·48
Other Public Works ...	·44	·76	·37	·65	·12	·68
Military Receipts ...	2·05	6·66	4·81	...	4·39	...
Extraordinary Receipts ...	...	...	2·59	...	·63	1·55
Provincial Contributions ...	...	...	8·83	–8·83	6·08	–6·08
Total Revenue ...	127·81	215·01	132·78	78·85	133·17	87·51

EXPENDITURE.

	1913-14	1920-21	1923-24 Central	1923-24 Provincial.	1925-26. Central.	1925-26. Provincial.
	Crores of Rs.	Crores of Rs.	Croses of Rs.	Crores of Rs.	Crores of Rs.	Crores of Rs.
Direct Demands on Revenue	13·91	22·50	5·44	10·67	5·37	10·55
Interest (Debt Services)	2·27	16·37	17·33	1·85	18·34	3·27
Posts and Telegraphs	4·90	9·43	·25	...	—·01	...
Mint and Currency	·19	·28	·99	...	·70	...
Salaries and Expenses of Civil Depts	26·90	45·55	9·33	44·26	10·76	49·16
Miscellaneous Civil Charges	8·10	11·24	4·46	6·75	4 25	7·02
Famine Relief and Insurance	1·50	1·50	...	...	...	...
Railways : Interest and miscellaneous Charges	19·25	19·37	26·25	—1·07	28·01	·01
Irrigation	5·29	7·01	·16	5·00	·20	6·11
Other Public Works	10·51	12·79	1·70	8·60	1·6[illegible]	9·59
Military Services	31·89	94·04	60·46	...	56·39	...
Extraordinary Payments	...	...	3·40	...	·25	·05
Total Expenditure, Imperial and Provincial	124·76	240·13	130·39	76·09	129·86	85·89
ADD :— Portion of allotments to Provincial Governments not spent by them in the year	·48	7·66	...	...	...	...
DEDUCT :— Portion of Provincial Expenditure defrayed from Provincial Balances	·91	6·77	...	...	...	...
Total Expenditure Charged to Revenue	124·34	241·02	130·39	76·09	129 86	85·89
Surplus	3·47	26·01	2·38	2·75	3·31	1·61
Grand Total	127.81	215·01	132·78	78·85	133·17	87·51

II

Year.	Gross Revenue.	Expenditure.	Surplus (+) or Deficit (—)
	£	£	£
1875-76	51,019,140	49,013,871	+1,668,945
1880-81	50,648,968	52,648,968	—2,420,930
1885-86	49,973,174	49,973,174	—1,867.818
1890-91	54,444,668	51,985,887	+2,458,781
1895-96	59,395,326	58,372,660	+1,022,666
1900-01	66,106,579	65,139,375	+1,670,204
1905-06	70,846,565	68,754,337	+2,092,228
1910-11	80,682,473	76,746,186	+3,936,287
1915-16	84,413,537	85,602,198	—1,188,661
	Rs. (1,000)	Rs. (1,000)	Rs. (1,000)
1916-17	147,07,56	135,85,83	+12,13,06
1917-18	168,99,35	156.86,29	+12,13,06
1918-19	184,88,66	190,61,72	—5,73,06
1919-20	197,48,59	221,13,88	—23,65,28
1920-21	215,01,84	241,02,69	—26,00,85
1923-24	211,63,33	206,48,23	+5,14,80
1925-26	220,68,50	215,75,65	+4,92,85

335. Burden of Taxation :—It will be useful to study the system of Indian taxation in three different periods viz. the pre-war, the war and the post-war period. This last coincides with the years during which the new distribution of financial resources and burdens as between the central and the provincial governments, was in operation. Though it is true that whatever the taxing authority may be, whether central, provincial or local, the burden ultimately falls upon the same body of citizens, the incidence of the taxation varies according to the nature of the taxes levied and the persons paying and the authorities levying them. Then again, the pressure of taxation must be con-

sidered in relation not only to the income of the tax-payers but to the benefit derived by the latter from the amounts expended by the taxing authorities. Looking to the needs of reform involving additional expenditure, one will easily realize that people can not grudge their governments and the local public bodies larger contributions in the form of taxes and rates. But three conditions must here be satisfied: (1) that the existing scale of expenditure should be so scrutinised as to result in all practicable economy; (2) that the outlay of public funds should be so directed that it may result in the greatest good of the greatest number; and (3) that expenditure and taxation should be subject to the rigid control of the representatives of the tax-payers so that the ultimate responsibility for both falls on the same shoulders. Now, these conditions are not satisfied in India to-day. Further, as indicated in passing, above, the statement that the people of India are most lightly taxed, is unwarranted. There is no absolute standard by which to judge of the lightness or heaviness of the burden of taxation, and the relation between it and the per capita income of the population, must be taken into consideration in judging in this matter. That the administration in India is more costly than it need be, that the country is one of the poorest on the face of the earth and that the people have little voice in levying and spending the taxes, are facts acknowledged by all. Expenditure regarded as essential for the healthy development of a nation, governs the amount of taxation to be raised, and therefore the former must be subjected to severe scrutiny. Military expenditure in India throws a heavy burden upon the country compared to its resources; and the children of the soil are excluded from their proper share in the composition and control of national defence. Retrenchment and economy and rapid Indianization in the military and the civil services are urgently and imperatively called for.

As an effect of the war, money lost its purchasing power very considerably all the world over, and governments had to raise vast sums by way of taxation out of the wealth of the population, decreased and impoverished by destruction. A comparison of the incidence of taxation in India with that in other countries is not obviously expected to be particularly helpful. That the amount of taxation per head of the population in this country is comparatively small, can not be denied. But the per capita taxation must be taken along with the per capita income of the Indian population, and it

will be found that the sacrifice borne by the Indian taxpayers is not lighter than that made by the citizens of any other country. It is not the absolute amount but the relative burden that is the true test in this matter.[1] And the smaller the income, the greater is the comparative sacrifice caused by a given amount of taxation. Recent estimates of the incidence of national and local taxation in the principal countries of the west give the following results. We add Indian figures for comparison—

	Taxation (National and Local) Per Capita	National Income Per Capita	Proportion of National Income Absorbed by Taxation.
	$	$	%
Great Britain	86·94	374·74	23·2
France	39·07	186·98	20·9
Italy	19·04	99·17	19·2
Belgium	24·80	146·06	17·0
United States	69·72	606·26	11·5
India	2·5	25·0	10 0

The aggregate tax revenue, central, provincial and local, of British India, may be taken at not less than Rs. 165 crores and this represents about 10 per cent. of the total national dividend. This ratio for a poor country like India does not represent a light burden and it makes no allowance for the many compulsory payments, which the rural population, in particular, has to make in kind as well as in money for the peaceful conduct of life's activities. Those who seek to make out that India is the most lightly taxed country in the world because it receives the blessings of efficient bureaucratic administration for a cheap price, attempt to prove too much. To speak of the incidence of Indian taxation with admiration or satisfaction, is besides like a wealthy man's offer of congratulations to his poor neighbour on the latter's comparatively insignificant burden of expenditure. We do not complain so much of heavy taxation in India; the burden of taxation must grow with the growing needs and wealth of the country. We find fault mainly with the methods of expenditure, the costliness of the administration and the inequality of the present incidence of taxation. In the future, proportionately more revenue must come out of the pockets of the wealthy than now

1 "It should be understood that the actual taxation in a country does not necessarily represent the true tax burden on the people of that country. It is the relation of taxation to national income which constitutes more nearly the real tax burden."—The Economist, 27th June, 1925.

and the expenditure of the State must be economised and judiciously laid out. The haste with which government raised the scales of the salaries of highly paid officials and made many appointments of Europeans on the eve of the inauguration of constitutional reforms, calculated to confer greater political power upon Indians, was not reassuring; and the new councils were handicapped by the huge commitments of government. The question of the Indianisation of the higher services has, likewise, caused bitter heart-burnings and has raised supremely important and highly delicate issues. No real fiscal reform is possible till the cost of administration is substantially reduced, and Army expenditure has been the key to the solution of this aspect of the problem. Public funds must be so expended that they tend to increase the productive capacity and the income of the people.

336. The Land Tax :—Taking the national system of taxation as a whole and without making a distinction between the central and the provincial sources of revenue, let us now proceed to examine the different heads of government's income and the nature of the taxes the people have to pay. The land tax is now entirely provincialized but it is an element in the total burden of taxation which the people have to find for the expenses of the administration. Landlords and cultivators must certainly contribute, according to their ability, to the revenues of the State, and unearned increment must be more heavily taxed; but not to count the revenue they pay as a tax is hardly correct or fair. Enhancement of the land tax has been effected from time to time; and on the theory of State landlordism, it did not require legislative sanction. Under the constitutional reforms of 1919, the revision of land revenue settlements is brought under the control of provincial legislatures. But administrative practice has not yet been adjusted to the change, and the laws have yet to be suitably amended. Land revenue is, in the case of substantial Jamindars, in practice as well as in theory, a tax upon the income landlords derive from the tenants cultivating their farms, and there is apparent justification in the policy of the State to take a certain proportion of that income. The Indian land tax is erroneously regarded as a rent and works out as a property tax where, as often happens, it is not calculated to act as a tax upon agricultural income. In the latter shape, it must be regulated by the principles which apply to income and other taxes. If the land tax

is avowedly a share of the net produce of the land, that is of income, there is no reason why exemption should not be allowed to a minimum as in the case of the income tax. If a salaried man or a shopkeeper with an income of any amount less than Rs. 2,000 a year, earns exemption from the payment of the income tax, the smaller cultivator may claim similar concession in the matter of the land tax.

In all countries the land tax is a source of revenue to governments. In former times a general property tax was levied e. g. in England, but it tended to become a tax on land and houses; and other forms of property e. g. personalty, escaped taxation altogether. These forms of property are now almost everywhere brought within the net of taxation. It is, however, produce or income rather than property that is taxed. Taxes must really be levied upon persons and corporations and not on property, and this is the accepted principle underlying the income taxes of all countries. The State in India has moved in its old grooves all these years and has not modified its policy of taxation so as to suit changing conditions. We do not wish to suggest that the land tax could have been or should be given up; we urge that there should be equality and equity in its incidence and that it should be assessed according to the ability of the tax-payer. A poll tax or a property tax, is a crude method of raising State revenue and leads to inequality and injustice. To-day the land tax is assessed, in Bombay and Madras, upon each acre according to fertility, prices, general progress in villages and other conditions, irrespectively of the ability of the owner of the land to pay. Because a certain piece of land is presumed to be able to yield a certain amount of produce, therefore, it must pay from a sixth to a tenth of that produce to the State. Land is taken as an index of the ability of its owner to contribute to the expenses of the State; but his net income is hardly considered or taken into account. The land tax assessed on petty cultivators, is justified on the ground that it is practically the only contribution that a large proportion of the population pays to the State in India and that if it were excused or abolished, a large section of the community would pay nothing to the national exchequer and would yet make no appreciable saving.[1]

The fact is that in numerous instances, the land tax is not actually paid out of profits from land, but out of other earnings viz.

1 The attention of the reader is invited to the discussion of this whole subject in the Appendix to Chapter XV.

wages. Why should the agricultural labourer–because the cultivator is often nothing more–be made to pay an income tax when craftsmen, artisans, petty shopkeepers and moneylenders, better circumstanced than he, are exempted from it? Simply because land is supposed to be the property of the State which represents the nation or is a monopoly of the favoured owners? Most of the holdings in rayatwari provinces are notoriously uneconomic and the cultivator has to supplement his scanty agricultural income by work elsewhere.[1] And yet he must pay the land tax. The indebtedness of rayats is heavy and the tax may often have to be paid out of borrowings and not out of agricultural profits actually realised. While the money-lender may not pay an income tax, the cultivator who borrows from him has invariably to pay it; and the land tax turns out to be a tax not upon ability but on liability. This is a serious defect of a general property tax and is present in the Indian land tax, at least in the case of poor rayats. The tax has, besides, been levied and raised by mere executive action and it has thus offended against most of the important accepted principles of taxation. Land is an object better suited to local than national taxation and the tax may be conveniently handed over to local authorities. Even so, the tax on landed property will indeed have to be assessed on the principle of "annual valve" or profit from agriculture, and must, therefore be low enough. What should be the basis of the tax has been a subject of controversy in the Bombay Presidency and elsewhere,[2] and it will be dealt with presently. Sufficient funds must, of course, be raised by taxation or otherwise to enable the State to perform its beneficent duties towards the people. India is a poor country with agriculture as its predominant industry. The number of rich people or people who stand much within the margin of subsistence, is very small; and, therefore, a direct tax like the income tax or a succession duty is not likely to be very productive. This is the reason why the land tax has occupied such an important place in the tax-system of this country. It has also the advantage of being an ancient and a familiar tax which the people have been paying from time immemorial. A government situated as the British government in India is, has, for

1 See Dr. Mann's "Life and labour in a Deccan Village." The number of landholders paying Rs. 1 to 5 as assessment in a village is very large and the average extent of a holding is between 1 and 2 acres.

2 Read Report of the Land Revenue Assessment Committee, Bombay, 1926.

this reason, followed the line of least resistance, tenaciously clung to this source of revenue and done its utmost to improve it independently of other considerations. The Taxation Inquiry Committee's views and recommendations in this connection, will be referred to later in this chapter.

337. Permanent Settlement:—The permanent settlement of the land tax in Bengal has been the subject of prolonged controversy. Objection has been taken to it on the ground that it has entailed on the State considerable loss of revenue. While the land tax in the other Provinces has steadily increased and the State has shared in the benefits of extended cultivation and rising prices, derived by the landholders and the rayats, it is urged, the Jamindars in Bengal whose estates have steadily yielded them a higher rent, have their tax permanently fixed and have not made their proper contribution towards the growing expenses of the State. This is, in the opinion of the critics of the permanent settlement, grave injustice to others than landowners and to other Provinces whose people have had to bear an increasing burden of taxation.[1] Provincial autonomy has, of course, now weakened the force of the latter argument; but the special treatment accorded by the Central Government to Bengal in foregoing its contribution for three years, evoked angry criticisms and created dissatisfaction in other provinces. The rent received by the Bengal Jamindars from their tenants, has increased fourfold, to more than Rs. 16 crores but the amount of the land tax they pay to government remains what it was in 1793, viz. a little more than Rs. 3 crores. It is, therefore, suggested that they may, in equity, be called upon to take up a larger share in the public burdens, in one way or another. But it is contended, on the other hand, that the landlords " must either be bought out altogether, or

1 " If, therefore, the finances of the country are to be maintained in a state of solvency, either we must impose heavier burdens on the people in new and unfamiliar shapes, raise the cost of living to the poor, exact the highest contribution which can be levied from the other Provinces with each revision of their land assessment—in fine, cripple the country's resources, arrest its prosperity and disturb its peace—either we must do this or Bengal must pay her fair share of revenue along with the other interests and other Provinces, constituting the Empire. As a measure of justice as much as of necessity, the Bengal settlement must be remodelled, and the fact that the conditions— the purposes or intentions—with which or upon which the settlement was made, have not been fulfilled, adds increased force to the demand."—Hector: Indian Fiscal Administration.

such compensation as they may be entitled to, be offered to them before any additional contribution can be demanded."

The Jamindars are naturally very tenacious of their rights and resent, as an unwarranted invasion of them, the mere suggestion of further taxation of land in Bengal. Apart from all political and social considerations, the argument that 'many of the present holders are bonafide purchasers for value given; that they bought on the faith of the settlement being what it professed to be, a settlement in perpetuity; that any obligations which it is sought to throw upon them, having been allowed to lie dormant and inoperative must be regarded as non-existent,' is too weighty to be brushed aside however desirable it may be that unearned increment should be taxed and the Bengal Jamindars, like other people, should be made to contribute their fair share towards the expenses of the State. And it is not easy for the State to devise a workable scheme for buying up or compensating the landlords.

If we take into account the circumstances in which the Jamindars were confirmed or acknowledged in their position of proprietors who were to retain for their trouble only one-tenth of the rent collected by them from the cultivators and to pay nine-tenth to the government, viz. the State; the utter confusion and waste into which Bengal had fallen; the total failure of all previous efforts to bring order out of this chaos; the great difficulty the Jamindars experienced in collecting and regularly and punctually paying the *Jama* into the public treasury; the sale of several Jamindaris by auction for default; the infinite mutations which have taken place in the estates; the frequency with which and the high prices at which they have changed hands; the measures which have been taken to strengthen the position of the tenants—if all these things are carefully considered, the case of the Bengal Jamindars will be pronounced to be strong. But even in Bengal, land is subjected to local taxation e. g. the road cess; and if this is not an encroachment upon the rights of the Jamindars, fresh burdens dictated by the needs of the progress of the community, can not justly be resisted by the landlords. They can not, therefore, reasonably claim exemption from new or additional taxes which must press with uniform weight upon all classes and with greater rigour upon the wealthy.

The Bengal Jamindars succeeded in 1918, in compelling the Government of India to drop their proposal, not indeed to assess the

rent from land to the income-tax but to take that income into calculation in assessing the non-agricultural income at a higher rate. The opposition to the proposal was not reasonable and the Jamindars can not long continue to dodge the tax-gatherer in that way. The Bengal Jamindars were subjected to the first regular income-tax imposed in 1860 like every other landholder in India with an income of Rs. 200 and more, and had to pay that graduated tax besides the ordinary land revenue. It may be argued that the payment, for several years, of as much as 90 per cent. of their total collections of rents to the State by way of taxation, has purchased for the Jamindars exemption from an increase in the assessment, and that on the analogy of the Jahagir and Inam tenures under which the landholders are not liable to pay anything more than a small fixed amount to government which has permanently "alienated" its claim to enhancement of the land revenue, the Bengal Jamindars can justly take their stand upon the alienation of an increase solemnly promised in 1793. The above contention is met with the reply that the principle of equity and equality of sacrifice must be paramount in the distribution of fiscal burdens and that the permanent settlement can not be pleaded as a bar against any new general tax that may be imposed upon the incomes of all classes of people. The financial position of Bengal under the Reforms is already calling for readjustment in this regard and the Jamindars will have to pay an income-tax as landlords have to do in Great Britain. While land revenue is Rs. 2½ and Rs. 1-10 per acre of cultivated area in Madras and Bombay, it is only Rs. 1-2 in Bengal. The per capita incidence of the land tax in the three Provinces is Rs. 2, Rs. 2-5 and As. 10 only. This shows the lightness of the burden in Bengal. It is stated that while tenants who have to pay heavy rents to the Jamindars, are also subjected by them to numerous extra levies viz. the *abwabs*, the latter continue to enjoy the privilege of a permanent settlement. It is, therefore, suggested that a succession duty and a graduated income tax should be imposed on the Bengal landlords.[1]

338. Non-tax Revenue:—The land tax must be removed from the category of sources of what is called non-tax revenue, and must be classed as property and income taxation. The non-tax

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1 Read article on "Rent and Land-Revenue in Bengal" in the *Indian Journal of Economics* for July, 1929, by Prof. J. C. Ghosh.

revenue consists mainly of receipts from Forests, Opium and Tributes, as also from commercial undertakings like Railways, Irrigation works, the Post Office and Telegraphs &c. There are, besides, several minor items of income, which are departmental receipts and are in the nature of prices and fees for services directly rendered to the public. They are included in gross but excluded from net revenue. The manufacture of opium is a State monopoly and the revenue from this source is derived from the profit on the production and supply of the drug. Opium is sold to foreign countries and for local consumption in India. The Government of India used to earn considerable profits from this monopoly throughout the last century, and China was a great customer for the Indian product. The Indian government attempted to maintain the trade in opium with China in spite of the resistance of the government of the latter country. The Society for the Suppression of the Opium Trade started in England by philanthropists to protect the Chinese against the inroads of the Indian drug, achieved little success, and it was only in 1907 that the Indian government decided to co-operate with the government of China, who were determined to put a stop to the evil of opium-smoking in their country, in reducing the supply and the production of opium. The revenue derived from this source by the Government of India was, at one time, considerable and for years went on steadily increasing as the result of a growing foreign demand; but owing to an agreement with China, it steadily declined and has almost reached the vanishing point. This is a heavy sacrifice of income, and is likely to be regarded as altogether uncalled for, but it is calculated, at any rate, to yield satisfaction that India has helped a neighbouring nation to put down a degrading vice so rampant in China, especially as the British government was responsible for forcing the opium traffic upon an unwilling Chinese government, though, at the same time, excise and drink revenue has gone on merrily increasing in this country! In the midst of the chaotic conditions which have long prevailed in China, it is difficult to ascertain what truth there is in the report that poppy cultivation and opium manufacture have been resumed there. It is a question worthy of serious consideration if it is not a little quixotic for India to run to the rescue of a foreign country which does not seem to be keen on saving itself, and for the British nation to practise altruism through Indian opium, at the cost of considerable revenue to the government here. And all this time, drink revenue in India

has remained on a high scale! The question has since been taken up by the League of Nations and the consumption of opium in India has been vigorously attacked.

Forests form a valuable State property of immense possibilities and income from them has steadily increased.[1] It will continue to expand as forest products come to be utilised more and more for industrial purposes and forests come to be more carefully and thoughtfully developed and exploited. The principle that such properties as forests should always be national, is already in operation in India, and the nation is not likely to lose control over that important asset. The question of the exploitation of the timbers in the Indian forests has recently been much discussed; and efforts have been made to bring those timbers to the notice of the British public and to popularise them in England. The exhibits of the Government of India at the Empire Timber Exhibition of 1920 are stated to have produced a very favourable impression. A strong point has been made of the anomaly that imported timbers are used for railway carriages when superior varieties of wood are available in this country. In its forests India is represented as having a rich gold mine which is not being intelligently worked, and scientific and commercial exploitation of that source of national wealth is being very rightly advocated.[2] The annual revenue from government forests is about 1¾ crores, the gross value of the forest produce exceeding Rs. 5 crores. Not only is it disadvantageous to allow forests to be exhausted and permit these profits to go into private pockets but it is dangerous to permit the creation of a monopoly of such natural resources in private hands.

Production of revenue is not the object of the conveyance of letters and parcels, remittance of money and similar other business undertaken by the State Post Office. Private management will not

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1 Refer to pages 91-95 in Volume I.

2 "The railway carriage in which I journeyed here was trimmed with American Maple panels. I have also seen in other carriages American walnut, Australian Silky Oak and other foreign timber. What surprises me is that for every one of such timbers as these which you purchase from other countries you possess within your own boundaries infinitely more valuable and suitable woods for the purpose which I have not seen in any railway carriage and the cost of which even now must be less than a third of those actually used in these cases." —Lecture by Mr. A. Howard before members of the Indian Legislature, in 1922.

be able to do such work efficiently and cheaply, and it is in the public interest that it should be undertaken by the State. The Post and Telegraph Department renders great social services and its management by the State has proved exceptionally useful to the community. The whole business is now placed on a commercial footing, and the revenue and capital accounts are separately maintained. The net contribution of the Post and Telegraph Department is about a half to one crore of rupees. The payments made by the public to the Post Office are prices for services rendered; and duties on stamps, commercial and judicial, are partly fees, prices and taxes on acts. It is, of course, possible that the government charges for such services may be excessively high and may constitute a monopoly price. The public has regarded the increase in the price of the post card and the one-half anna packet as enhanced taxation and to a certain extent this is quite true. Stamp revenue is obviously derived from taxation and the revenue from registration is largely a fee and partly a tax.

339. Railways:—Indian railways represent a large-scale commercial activity of the State and have now become a remunerative business constituting a valuable financial asset of the country. The bulk of the Railways in British India are the property of the State and, excepting a few of them, are directly managed by the State. The Railway problem in India has two aspects, the economic and the financial. Having been initiated by the State and largely financed by it, revenue considerations in relation to the Indian Railways have been as important as those of national economic development, affected by them. For years, they were not paying concerns to the State and have involved a total loss of about Rs. 50 crores. Since 1901, they have, however, been contributing a fairly large and increasing quota to the national revenue. The revenue from them indeed fell off on account of higher working costs and economic depression in post-war years, and charges for the conveyance of passengers and goods had to be raised. Total gross earnings of State lines now exceed Rs. 105 crores and their working expenses are about Rs. 68 crores. On the capital at charge of the State lines the net receipts, that is the gross receipts *minus* the working expenses, have given an average return of about 5 per cent. during the past few years. Recent actual figures are given at the end of the next section.

The importance of railways for the economic development of the country, is undoubted. But railways having long been a burden upon the State treasury, which could ill bear it, a rapid extension at the cost of the tax-payer, was most unpopular. We have also shown in the chapter on Trade and Economic Transition what effect railways have produced on the indigenous industries of India and compared their expansion with the extension of irrigation works. Certain commercial interests long pressed for a large annual railway construction programme, and a standard of Rs. 18 crores a year was laid down only a few years ago. The necessary extensions and improvements of railways must, of course, be effected, but the liabilities must not be increased in such a way that they would lead to a deterioration of the financial position. The Finance Member had in 1913 to administer a warning in this connection to his critics who wanted to hasten the pace. He said that the railways must never be allowed to become, even temporarily, a net burden on the general tax-payer.[1]

In some countries like Prussia, the railways, as in India, are State property and they are a large source of revenue. The Indian tax-payer having paid for the railways and suffered losses, it is but due to him that they should be made a permanent source on which reliance may be placed for yielding a substantial amount of revenue. The prosperity of the railways depends upon the character of the monsoon and the state of the external and the internal trade, and their profits no doubt introduced an element of uncertainty in Indian finance, which used at one time to be called a "gamble in rain" and was later characterised as a "gamble in railways."[2] But if properly looked after, as Sir G. F. Wilson suggested they should, they must prove a splendid financial asset. During the period of war, repairs and renewals had to be postponed; the gross receipts were high and the working expenses comparatively low. The income to the exchequer was, therefore, Rs. 10 crores a year on the average of the five years 1914-15 to 1918-19. The profits declined thereafter and turned into losses.

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1 "As matters stand, we have in our railways a splendid asset. Let us safeguard that asset. Any admission of doubtful schemes or failure to count in each case the full cost, any disregard of financial considerations, will surely lead to deterioration of a most serious character":—Sir Guy Fleetwood Wilson, introducing the Financial Statement for 1913-1914.

2 See D. E. Wacha's "Railway Finance" and "Recent Indian Finance."

340. Railway Policy :—The bulk of the Indian railways have become State property but all of them are not directly managed by the State, a few being still under the management of companies who give the State a fixed share of their profits. Before the East Indian and G. I. P. Railways were taken over by the State for direct management five years ago, only 8,000 out of a total of 27,000 miles of railways owned by the State, were directly managed by it. "At the end of March, 1926, we had altogether 38,579 miles of railway in India. Of this total the State owns 27,430, Companies and District Boards own 6,187 miles and Indian States 4,962 miles.........As regards management, the four large State managed railway administrations, viz. the N. W. R., E. I. R., G. I. P. R., and E. B. R. make up 15,543 miles while 8 other administrations owned mainly by the State but managed by Companies under contract with the Secretary of State account for 17,295 miles."[1] Whether all the State railways might not be profitably managed by the State, was, therefore, for years, a subject of keen controversy. This important question was raised in the Supreme Legislative Council in 1915, and it was proposed that on the expiration of the contract of management with the East Indian Railway Company in 1919, the management of that railway should be assumed by the State. A similar resolution was moved early in 1918, and as before, opposite views with regard to the State management of railways were maintained. The arguments of the two sides may be found summed up in a memorandum on the subject prepared and published by the Railway Board in 1916. The pros and cons involved in the controversy relating to railway management are likewise instructively set forth in the Report of the Indian Railway Committee.

From the point of view of economy and efficient management, it is urged, company management is more desirable and a vast railway undertaking in the hands of the State, is deprecated. The directors of a company and its servants, the argument runs, must try their utmost to cut down costs to earn profits while bureaucratic management will be indifferent about the matter. But even the organization of companies tends to be bureaucratic and their servants are not more efficient than those of State-managed railways. And the strongest argument against the companies was that they did not

1 Speech by Chief Commissioner for Railways in Council of State in presenting Railway Budget for 1927-28.

care to encourage indigenous industries and trade and the Indianisation of their higher offices. Foreign management, the drain of the companies' profits abroad and neglect of the interests of third class and generally of Indian passengers and employees, were additional pleas advanced against the companies. In England, America and France, railways are private properties but in Prussia and other countries they are the property of the State, being also managed by the State. From the financial as well as the economic and the social point of view, State management of Indian railways is, on the whole, preferable. This was also the view of a majority of the members of the Railway Committee, of 1920-21, who rejected the alternative scheme of the minority about management of railways by companies domiciled in India. Management by companies was really a misnomer in as much as the railway property belonged to the State and the companies contributed only a fraction of the total capital.

We need not here enter into the history of railway construction in India; nor need we go into the details of the controversy regarding the system of their management. State policy in this matter has changed from time to time. Railway construction was carried out for years since the initiation of the enterprise about 1853, through joint stock companies started in England, under contract with the State. The companies were guaranteed interest at 5 per cent. on their capital outlay and in addition half the surplus profits. They were bound to sell their railways to the State after 25 years. This guarantee system imposed a heavy burden on the revenues of the country and was discontinued in 1869. From 1870 government began to borrow for railway development by direct State agency and the railways constructed during the next ten years, were operated and managed directly by it. But it was found that under this system progress was extremely slow. The State had, therefore, in 1880, to fall back upon the old guarantee system, only modified so as to ensure easier terms for government. Vigorous efforts have since then been made to push on railway construction and to attract private capital for the promotion of feeder lines by means of tempting terms.

This subject of the management of the State Railways and the financial separation brought about in relation to them, will be discussed at length in the next chapter. It will suffice to state here

that the principle of direct management of State Railways, has now been admitted and a secure contribution from these Railways to the annual national revenues has been provided through the separation of Railway finance from general finance. Under a convention adopted in 1924, the Railways make a fixed contribution to the national revenues at the rate of 1 per cent. on the capital at charge of commercial lines plus one-fifth of the surplus profits of the penultimate year. They have to pay in addition, one-third of the excess over 3 crores of any surplus remaining to them after the payment of the fixed contribution. This total annual contribution amounts on the average to Rs. 6 crores. State Railways are now managed as an independent business, with its borrowing, construction and sinking fund programme, which is saddled with the definite obligation to make a certain contribution to the State exchequer from year to year. The taxpayers' interests are thus safeguarded while the needs of the economic development of the country are properly looked after. Railways render a highly useful public service, and their political, social and economic importance is great. Their utility and their capacity to produce State revenue are, however, often seen to conflict and have to be nicely adjusted. State-management and control are, in any case, preferable to private monopoly.

The financial position of State Railways will be clear from the following latest figures relating to their working :—

(In Crores of Rs.)

	Accounts 1928-29	Revised Estimate 1929-30	Budget 1930-31
Total earnings (Commercial lines)	110·34	109·38	111·78
Gross receipts of State Railways	102·67	102·86	106·11
Working expenses ,, ,,	64·83	65·72	68·08
Net receipts ,, ,,	36·24	34·61	36·80
Net receipts of strategic lines	·31	·45	·45
Total Receipts	37·48	36·20	38·10

Contribution from Railways to General Revenues.

For 1929-30
(Based on actuals, 1927-28)

	(Crores of Rs.)
1 per cent. on capital at charge, commercial lines, of Rs. 662·32 crores	6·62
$\frac{1}{5}$th of surplus of Rs. 5·91 crores	1·18
	7·80
Minus loss on strategic lines	1·68
Net contribution	6·11

For 1930-31
(Based on actuals, 1928-29)

	(Crores of Rs.)
1 per cent. on capital of Rs. 693·73 crores	6·93
$\frac{1}{5}$th of surplus of Rs.2·59 crores	·51
	7·45
Minus loss on strategic lines	1·72
Net contribution	5·73

341. Irrigation Works:—One of the most remunerative and, from the economic point of view, important commercial undertakings of the State, consists of irrigational storage works and canals constructed and maintained by government. Wells and often smaller tanks are the property of private individuals, but the larger tanks and the big canals are State property. In the interests of the country as a whole, it is necessary that canals, so useful to the agricultural industry, and therefore to the well-being of the nation, should be the property of the community. Irrigation works are not undertaken by the State primarily with the object of making a profit. If left to private enterprise, they would not be constructed and be properly managed. The indirect financial benefit derived by the State from irrigation works, is undoubted.

Financially considered, irrigation works used to be classed as 'major' and 'minor', the former being subdivided into (1) Productive and (2) Protective works. The most important irrigation works in India were those classed as 'Productive works' or works the capital cost of which had been "wholly or mainly provided from loan funds in the expectation that they would prove directly remunerative and that the net revenue derived from them would fully cover all charges for interest within a reasonable time after their completion." 'Protective works' were sanctioned for their value in affording protection against famine and were, therefore, not expected to be directly remunerative. For only a few 'minor works' were capital and revenue accounts kept, all expenditure connected with the construction and maintenance of these works being met from ordinary revenue. Since 1921–22, the old distinction between Major and Minor works has been replaced by a division based on the possibility and the desirability of maintaining *quasi* commercial accounts and the productive or unproductive character of the works. It was a long-standing complaint that the State had not paid as much attention to irrigation works as to the railways though the extension of the former was equally vitally necessary from the point of view of agricultural prosperity. During the past twentyfive years, however, the pace has been accelerated and many important works have been executed and are under construction and in contemplation, irrigating thousands of additional acres. Under the new system of decentralized finance, irrigation is a Provincial "Reserved" subject and the Provinces are given much greater freedom than before in respect of irrigation

works included in their areas. Large projects e. g. those estimated to cost over Rs. 50 lakhs are, however, referred to the central government for the sanction of the Secretary of State and the financial responsibility of local governments has correspondingly increased.

The following table illustrates the financial position of irrigation works:—

1925–26.

Works for which capital accounts are kept		*Total, Central and Provincial (Lakhs of Rs.)*
I—Gross Receipts		
Direct Receipts	...	**666·59**
Land Revenue due to Irrigation	...	**434·43**
Total	...	**1101·03**
Deduct—Working Expenses	...	**369·61**
II—Net Receipts	...	**731·41**
Interest on Capital	...	**356·47**
III—Net Revenue	...	**374·94**
Works for which no capital accounts are kept		
IV—Revenue	...	**28·77**
V—Expenditure	...	**164·67**
VI—Net Expenditure	...	**135·90**
Capital outlay		
Capital outlay during the year	...	**6,09·00**
" " to the end of the year	...	**96,03·95**

342. Customs:—The indirect taxation of the public through the charges levied upon the import, export and transport of commodities, has ever been favoured by rulers. The bulk of this tax is, in modern times, collected on the entry of goods into a country from outside and a few commodities going out of the country are also subjected to a charge. The rates of these customs duties and the methods of levy, e. g. *ad valorem* or specific, will depend on the nature of goods to be taxed, the productivity of the duties and the need of the national exchequer. In other countries a large amount of revenue is raised from customs, whether the tariff is a purely revenue or a protective tariff. A brief history of the customs

duties levied by the Indian government, has been given in the first volume.[1] In India, the tariff has all along been on a free trade basis, and a small 5 per cent. *ad valorem* import duty, varied according to the nature of articles, was imposed, the duty on cotton piece goods being only 3½ per cent., counterbalanced by a corresponding excise duty. It was believed that in a poor country like India, with unlimited undeveloped resources and with abundant raw materials, freedom of exchange with foreign countries was a primary need. Sir John Strachey observed.[2] :—" Here then is a country which, both from its poverty, the primitive and monotonous condition of its industrial life and the peculiar character of its political condition, requires from its Government before all things the most economical treatment of its resources and, therefore, the greatest possible freedom in its foreign exchanges." From the time of Mr. James Wilson in 1859, import duties were systematically and successively reduced with the above object in view.

Curiously enough, exactly the opposite theory was propounded by a successor of Sir John, viz. Sir G. F. Wilson, who pointed out in 1911 that in such a country as India we must rely, for many years to come, largely upon import duties as an important source of revenue. Since Sir. Guy's time the tax on incomes has been more productive but his proposition is as true to-day as it was when he laid it down. Customs duties constitute indirect taxation of a convenient kind which falls upon almost call classes of people, particularly the higher and middle classes, and has the advantage of being substantially productive. Sir G. F. Wilson's argument has received added strength from the financial difficulties of the Exchequer during and after the war ; and customs have become the dominant source of the Government of India's revenue. The tariff has been raised to yield ever-increasing amounts to the treasury and has been found so handy and easy to manipulate.

We have treated the subject of tariffs at some length already[3] and need not go over the ground again. It is sufficient to observe that content at first with a low tariff, the Indian government was compelled to effect an all-round increase in the duties by the pres-

1 See pages 417-419

2 Financial Statement, 1878.

3 See chapter X above.

sure of war conditions and though reductions may be made here and there, India must depend, to a great extent, on the indirect source of revenue provided by customs duties, import and export, if the State is to secure the resources required for progressive administration. The necessity of meeting the situation created by the War, forced the hands of government; and in 1916, new import and export duties had to be imposed and the old ones increased.[1] Sugar, jute, tea and cotton piece goods were the chief articles selected for an increase of duty and new taxation and it was an eminently wise selection. In 1916–17, the changes in the tariff were calculated to yield an additional revenue of £ 2,150,000. One million more was obtained by the enhancement of the import duty on cotton goods from 3½ to 7½ per cent. in 1917–18. The rates of the jute duty were doubled and were expected to produce £ 400,000 and a surcharge, yielding the same amount, was imposed on railway goods traffic. Customs yielded £ 5,873,886 in 1915–16; in 1918–19, they produced £ 12,120,641 and in the budget for 1920–21, the receipts were taken at £ 17 million. The rates of import duties were again enhanced in the budget for 1921–22; the increase being calculated to yield an additional 8 crores of rupees. The general *ad valorem* duty was raised from 7½ to 11 per cent. except on matches and articles of luxury which were also taxed at higher rates. The latter, including motor cars, matches, umbrellas &c. had to pay 20 per cent. instead of 7½ per cent. The duty on sugar went up from 10 to 15 per cent. Wines and liquor imports also came in for an increase. The obstinate opposition of the representatives of Lancashire in Parliament to an increase in import duties on cotton piece goods from 3½ to 7½ per cent., unaccompanied by a corresponding increase in the excise

1 "The general tariff rate on imported articles which stood at 5 per cent. *ad valorem* since its imposition in 1894, was raised to 7½ per cent. with effect from March 1916. In addition to articles grouped under the 7½ per cent. *ad valorem* rate are those free of duty, liable to duty at special rates and at 2½ per cent. Gold, living animals, raw cotton, wool, cotton machinery &c. are admitted free; special duties are levied on sugar at 10 per cent.; on silver bullion and coin at 4 annas per oz; on silver manufactures at 10 per cent.; coal 8 annas a ton; arms 20 per cent; cigars and cigarettes 50 per cent;......Iron and steel, railway material &c. are charged at 2½ per cent. *ad valorem*. The duty on cotton goods is now 7½ per cent. *ad valorem*. The export duty on raw and manufactured jute stands at Rs. 4½ for raw jute per bale of 400 lbs. with a special rate of Rs. 1½ per bale on cuttings and at Rs. 20 per ton for sacking goods and Rs. 32 per ton on hessiens. The export duty on tea is Rs. 1½ per 100 lbs."—See Review of the Trade of India for 1916–17.

duty, the Secretary of State's defence of the policy of government and the attitude of the Liberal and Conservative parties in the matter, proved eminently instructive. The further increase to 11 per cent. was defended on the ground of desperate necessity.[1]

In the absence of suitable direct sources of revenue, customs duties have to be levied on a considerable scale. In imposing these duties, care has to be taken to see that they will not press hard upon the ordinary consumer and give an undue advantage to particular interests. Import duties, it is said, make articles dear to the consumer; but if he is to be taxed, as he has to be, it is better to make him pay in this indirect manner. Lancashire and British free traders sympathise with the Indian consumer; but it is only the consumer of fine English fabrics and other foreign articles that will benefit by a policy of free imports. If other taxes are levied or increased, the ordinary consumer will be hit much harder and even his food will become dearer. Poorer classes in India are content with country-made goods and they will not be much affected by customs duties as they will certainly be if salt and land for instance, are more heavily taxed. Promotion of indigenous industries, is comparatively a secondary consideration when we are dealing with State finance, but it is one which can not be altogether ignored. As Mr. Austen Chamberlain, the then Secretary of State for India, pointed out to Lancashire manufacturers when they protested against the enhancement of the import duty on cotton piece goods, they want a free market in India as a protective measure and similar protection may be claimed by other interests. Preferential duties are advocated on the above ground by British tariff reformers and it is urged that the Indian tariff must be framed on the same principles. A duty of 15 per cent, levied on the exports of hides and skins with a rebate 10 per cent. in the case of Empire purchasers,—quite a protective measure,—was likewise calculated to mark the acceptance by India of the principle of Imperial preference introduced into the British budget by the Chancellor of the Exchequer, Mr. A. Chamberlain. Mr. Montague met the complaint of Lancashire against increased duties on piece goods imports by pointing to the

1 "At present our tariff is purely a revenue producing tariff which, whatever may be its effects here or there on any particular trade, is admittedly not devised with any object other than that of revenue."—Finance Member's speech introducing the Budget for 1921-22.

fiscal autonomy which the British Parliament itself had conferred on the Government of India. The plea of fiscal autonomy was similarly advanced in support of the increase of the import duty on cotton piece goods in 1930, and a preference of 5 per cent. was granted to Empire goods by raising the duty to 20 per cent. in the case of non-Empire cloth, as a voluntary concession and a gesture of good-will towards Great Britain.

343. Increased Duties :—The economic depression which overtook India along with other countries, in the place of the industrial and commercial prosperity which was anticipated on the close of the war, was the cause of serious financial trouble. The revenue did not rise to the expected level while the expenditure remained at a high pitch. Deficit, therefore, succeeded deficit, and revenue fell short of the expenditure by no less an amount than 90 crores of Rs. in four years. The gap was filled in two ways, borrowing and enhanced taxation. The subject of deficits and public borrowing will be specifically discussed in the next Chapter.

To return, therefore, to our narrative of the gradual increase effected in the customs duties as one of the principal means to bridge the yawning gulf between revenue and expenditure. Owing to the prevailing depression, the yield of the enhanced duties failed to rise to expectations. " The burden which the country is now invited to shoulder," said the Finance Member, in introducing the financial statement for 1922–23, "is a heavy one; we have done our best to distribute it as equitably as possible and to see that all classes of the community shall contribute, each according to its capacity." The first source to which the Finance Member turned, was the customs, and he observed—"The vast majority of customs duties necessarily fall upon the consumer, and the general character of the proposals which I am about to mention is, therefore, that of a tax on consumption." He proposed to raise to 15 per cent. the import duty on all articles assessed at the time at 11 per cent. The increase would have been made applicable to the imports of cotton piece goods; and to counteract the effect of this enhancement, it was proposed to raise the cotton excise from $3\frac{1}{2}$ per cent. to $7\frac{1}{2}$ per cent. Indian public opinion being particularly touchy on the question of the cotton excise, as a kind of compromise, both the increases were ultimately dropped. One argument against the increase was that

it would raise the prices of cloth and that it would be felt as a hardship by the poorer classes. And the plea ultimately prevailed. A large number of articles, however, such as sugar, kerosene, matches, motor cars, alcoholic liquors, and other luxuries came in for an increase, the last being taxed at 30 per cent. instead of at 20 per cent. as before. The excise duty on Kerosene was a tax on a necessary of life and would hit the poor and the middle classes. The import duty on machinery, iron and steel, and railway material was increased from 2½ to 10 per cent. and that on sugar from 15 to 25 per cent. The total increased revenue obtainable from the increase in customs was calculated to be about Rs. 15 crores. It was proposed to increase the salt duty from Rs. 1–4 to Rs. 2–8 per maund, but this increase was successfully resisted by the legislature and was dropped.

The financial position of government has not been sufficiently favourable to enable it to make any appreciable reduction in the customs duties in recent years and it has only been tinkering with them. The export duty on hides and skins was reduced to 5 per cent. in 1923. Next year, government stores were subjected to the usual import duties, and in 1925 some minor changes were effected e. g. the abolition of the import duty of 2½ per cent. on grain and pulses. The duty on petrol, imported and local, was fixed at 4 as. a gallon, instead of 6 annas for imported petrol, and the *ad valorem* duty on sugar was converted into a specific duty, mainly on account of the fall in the world prices of that article. In 1926, the excise duty on cotton manufactures was abolished. Next year, the export duty on tea was done away with, and the resulting annual loss of Rs. 50 lakhs was made good by assessing tea companies for purposes of the income tax, on 50 per cent. instead of 25 per cent of their total profits. The duty on motor cars was reduced from 30 to 20 per cent. *ad valorem* and that on tyres from 30 to 15 per cent. This was intended to lighten the burden on internal traffic, trade and industries. The duty on un-manufactured tobacco was, at the same time, raised from Re. 1 to Rs 1–8 as. per lb. In 1929, the import and excise duty on motor spirit was raised from 4 to 6 annas per gallon, the object of the increase being, as recommended by the Road Committee, to constitute a Road Development Fund out of which disbursements were to be made to Provincial governments for the improvement of roads. The latest change

that deserves special notice is the increase in the import duty on cotton cloth from 11 to 15 per cent. on all piece goods and 20 per cent. on non-empire goods, i. e. Japanese. Besides this proposal for enhancement of taxation in the budget for 1930–31 an all-round increase of Rs. 1½ per cent. in the duty on imported sugar was included and was estimated to yield an additional Rs. 1·8 crores. This increase in the sugar duty was not expected to hit the consumer in as much as the landed cost of the article had declined from Rs. 12·2 per cwt. the average of previous six years, to Rs. 8·6 per cwt. It was, for the moment, a purely revenue measure but might, later on, have a protective effect, which the indigenous sugar industry would welcome.

It will be seen from the above account how consumption taxes have increased of late and how both luxuries and necessaries, the former in particular, have been subjected to heavy imposts. The increase which has been made in the postal charges is also largely a tax on consumption though it may be looked upon as a price for a useful service received from the State. A surcharge on railway goods traffic had been imposed in 1920–21, and it amounted to a tax on consumption as it added to the prices of commodities. That tax was afterwards absorbed in the railway rates themselves which were raised in all directions. The cost of living was considerably enhanced by the increased payment the people had to make to the national treasury. Having the same problem to solve, the Provincial governments had been imposing additional taxation within the limits allowed to them. The increase in the duties on the imports of iron and steel effected by the special Steel Industry Protection Act passed in June, 1924, inaugurated a new epoch in the fiscal history of India. These duties and those adopted for the protection of the indigenous paper industry were avowedly intended to restrict imports and enhance their prices, and the larger yield of revenue due to the increased tariff, was available for paying bounties and subsidies to the protected national industries. The increase in the duty on cotton piece goods in 1930, had the same motive behind it, viz. protection and also Imperial preference. As the two intentions were combined in a composite measure, the latter had to be approved if the threatened Indian mill industry was to be saved. Customs yielded a revenue of Rs. 49·28 crores in 1928–29 and were estimated to give Rs. 54·47 crores in 1930–31, thanks to the increase in the cotton and sugar duties and the revival of the duty on silver.

The following tables will show at a glance how customs revenue has steadily mounted up during the past fifteen years :—

Customs Revenue.

I

	1913–14.	1916–17,	1918–19.
Imports (Sea Customs)	Lakhs of Rs.	Lakhs of Rs,	Lakhs of Rs.
Special Duties—			
Arms, ammunition &c. ...	6·6	7·3	5·0
Liquors, Ale, beer, &c. ...	8·7	6·7	4·8
Spirits and liquors ...	1,18·1	1,21·8	1,01·4
Wines ...	5·8	5·5	4·6
Petroleum ...	70·5	45·1	13·0
Silver bullion and coin ...	99·2	15·0	...
,, Manufactures ...	...	3·9	1·9
Sugar ...	92·3	1,30·0	1,69·4
Tobacco ...	29·2	45.0	83·0
Duty at 2½ per cent.			
Machinery ...	16·7	10·0	11·6
Metals, Iron and Steel ...	...	18·4	26·0
Railway plant ...	...	3·6	4·6
Duty at 7½ per cent.			
Articles of food and drink ...	30·4	52·0	57·0
Raw Materials ...	15·7	38·5	41·0
Articles Manufactured.			
(I) Cutlery, hardware ...	36·7	40·7	48·8
(II) Metals other than iron and steel. ...	30·1	11·6	23·2
(III) Cotton manufactures ...	2,12·9	1,79·6	2,78·7
(IV) Yarn and textile fabrics ...	44·4	61·6	58·2
(V) All other articles ...	1,06·2	1,69·7	1,85·4
Total Imports ...	9,36·0	9,90·2	12,57·0
Land Customs	5·6	7·7	8·3
Exports (Sea Customs).			
Raw Jute— ...	...	59·0	67·2
Manufactured ,, ..	...	58·8	1,46·8
Rice ...	1,28·7	86·7	1,11·1
Tea ...	...	42·5	43·8
Total Exports ...	1,28·7	2,47·1	3,69·1
Excise Duty on Cotton Manufactures. ...	54,3	44·6	1,38·1
Total Customs Revenue ...	11,33·7	12,98·8	18,18·0

II

	1919-20.	1920-21.	1922-23.	1924-25.	1929-30 (Budget.)
Imports (Sea Customs *Non-protective Special Duties.*)	Lakhs of Rs.	Lakhs of Rs.	Lakhs of Rs.	Lakhs of Rs,	Lakhs of Rs.
Liquors—					
Ale, beer and other fermented liquors ...	6·8	8·8	13·4	16·	23·55
Spirits and liquors ...	1,24·7	1,70·1	2,10·2	2,30·0	219·00
Wines ...	6·3	9·0	10 7	14·1	15·45
Sugar, all sorts, excluding confectionery ...	1,28·1	1,09·1	4,40·9	5,76·9	7,00·00
Tobacco	89·0	1,31·2	1,54·8	1,73·6	2,60·00
Mineral Oils	1,00·3	77·3	1,10·8	1,43·3	188·19
Cotton yarn and thread ..	...	...	48·8	51·4	42·55
Cotton piece goods—					
Greys	1,69·2	1,99·0	3,26·1	3,17·4	} 6,40·00
Whites	1,19·8	1,70·2	1,62·1	2,12·1	
Coloured	1,02·9	2,71·9	1,50·5	2,44·1	
Matches ...	15·4	16·5	1,53·6	1,13·9	25·00
Duty at 2½ per cent.					
Machinery	18·8	52·6	63·3	40·4	...
Other articles	·4	1·4	·8	1·1	·48
Duty at 10 per cent.					
Metals—Iron and Steel...	46·1	66·9	1,84·0	40·4	50·00
Railway Plant... ...	13·5	33·9	1,07·0	1·1	25·50
Duty at 15 per cent.					
Articles of food and drink	66·3	63·6	1,22·5	83·4	2,02·70
Raw materials &c. ...	33·1	38·2	76·0	47·4	86·14
Articles manufactured—					
Cutlery and hardware ...	55·3	1,28·5	1,33·4	1,19·9	1,53·50
Metals other than Iron and Steel ...	63·9	70·1	1,07·5	1,12·9	88·37
Yarn and textile fabrics...	45·8	1,05·4	1,03·8	1,42·9	1,89·62
All other articles ...	2,13·0	4,34·1	3,8[illegible]·1	4,01·9	4,18·00
Duties at 20 per cent.					
Motor cars and cycles ...	...	...	56·0	79·4	1,21·00
Silk piece goods (30 p.c.).	49·2	49·1	80 8	90·0	99·22
Protective Special Duties.					
Coal tubs	...	...	...	1·4	...
Iron and Steel... ...	...	...	...	2,15·8	2,96·50
Railway track material...	...	...	...	9·1	...
Government Stores	...	...	...	54·6	89·93
Total Imports ...	15,45·5	23,16·1	33,66·2	38,9·2	42,22·11
Exports (Sea Customs).					
Hides and skins ...	91·9	60·2	42·6	26·7	37·74
Jute—					
Raw	1,37·0	111·6	145·3	1,66·3	} 4,00·54
Manufactured	1,60·4	200·5	183·9	2,09·3	
Rice	37·2	60·2	108·0	1,23·9	1,16·25
Tea	54·5	42·0	44·4	49·1	...
Total Exports ...	4,81·1	4,83·6	5,24·3	5,75·5	5,54·53
Excise Duty on Cotton Manufactures ...	1,55·1	2,30·9	1,87·3	2,18·2	...
Excise Duty on Motor Spirit ...	41·4	54·2	65·3	87·4	2,49·33
„ „ Kerosene „ ...	...	...	91·6	97·6	98·58
Grand Total ...	22,48·1	31,89·1	42,71·8	48,92·7	51,21·77

344. Excise :—Another indirect tax and a tax on consumption, is the excise; and this revenue is derived from the manufacture and sale of intoxicating liquors, opium and hemp drugs. It is a tax upon luxuries in the case of those who indulge in drink and drugs in moderation and an impost upon a vice for those who use the noxious things to excess. There has been an alarming increase in this excise revenue during recent years and the growth is naturally regarded with grave anxiety as drink is one of the deadliest of evils from which society may suffer. It is, however, stated that 'the considerable growth of the excise revenue in recent years is due mainly to higher rates of duty and stricter excise control, and does not indicate a corresponding increase in consumption, although some increase has occurred through the expansion of population and the greater prosperity of certain classes.' It is unfortunate that the prosperity of the people should be associated with the growing consumption of liquor in a country like India where drinking has been condemned as a sin and a moral offence by religion and public opinion. Excise duties are imposed upon intoxicating liquors and drugs for controlling and discouraging their manufacture and consumption as well as for raising a revenue. Licenses to manufacture and sell are sold by auction or fees are levied and revenue from this source has fast increased, being now about As. 12 per head of the population. It may be argued that being a tax on a luxury, the excise is unobjectionable and should be welcomed by the general public who do not pay it. But it should be noted, that once government come to depend, to a large extent, upon this source of revenue they find it difficult to support and to encourage movements in favour of temperance and prohibition which threaten to cut down their income.

The question of drink and excise revenue has been debated for years in the press, on the public platform and in the legislative councils, old and new. Government has been asked to lay down a definite policy for discouraging the consumption of liquors, if not to stop it altogether, but the proposal has not been accepted. Excise is a provincial subject under the reformed constitution and the agitation in favour of 'prohibition', has, of late, been vigorous. Revenue considerations must certainly be subordinated to the promotion of the physical and moral well-being of the people. When the U. S. A. resolved to go 'dry' and other countries made up their minds to follow suit, hope was roused in the minds of Indian reformers that the prohibition movement could be successfully carried on

in this country. But the needs of social reform and the requirements of the exchequer are not easy to reconcile. A large proportion of provincial revenue is derived from excise, e. g. one-fifth in Bombay; and that is the chief reason why governments have little enthusiasm for temperance reform. The 'responsible' portion of the governments in the Provinces, who now controls the excise, as much as the reserved half, realizes that it is a revenue which can not be dispensed with. And the effective promotion of temperance, with a steady approach towards total prohibition appears to be the only feasible course. A steady reduction in the supply of liquor, with a view to the ultimate extinction of drink revenue in a few years, is a principle that has found some support in Bombay where the government has declared itself favourable to prohibition as the goal of its policy but is not ready to support legislation establishing the system of local option. It is likewise proposed to try the experiment of prohibition in one or two districts, conditions in which are favourable in relation to the prevalence of drink and the amount of excise revenue collected. The production and consumption of liquors and drugs have been taxed in India from time immemorial. But the modern attempt to defend drink on the ground that prohibition and temperance are an invasion of individual liberty, opens the large question of the relation of the State towards the private life of the citizens. The effect is, however, in many cases, a smoke screen thrown up in defence of the revenue of government.

There is quite another class of excise duties which are levied solely and deliberately with the object of creating revenue for the public powers by taxing the production and the consumption of aticles many of which are necessaries of life. Tobacco often stands on the borderland of luxury, necessary vice and is usually subjected to an excise duty. But the production and sale of other articles such as sugar and salt are also some times taxed. A reference should be made, in this connection, to the discussion of the problem of excise duties in the majority and minority reports of the Fiscal Commission. The view is expressed in the former that excise duties may be justly levied on articles like cloth whose production is concentrated in large factories or small areas, the tax being levied for revenue purposes only and care being taken that it does not press heavily on the poorer classes. The minority is opposed, on principle, to such duties and would restrict them to articles whose consumption is not desirable. Both agreed on historical grounds, that the cotton

excise ought to be abolished forthwith. Government, however, pleaded financial difficulties and deprecated a preference for the repeal of the cotton excise over the remission of provincial contributions. The continuance of a high import duty on cotton piece goods was likewise regarded as an unjust burden on the consumer, and the necessity of the investigation of the condition of the cotton mill industry by the Tariff Board was also pleaded. The cotton excise was at last abolished in 1926. The excise on motor spirit and kerosene, both measures of the war period, does not call for special notice.

345. The Salt Tax:—The salt duty is another indirect and consumption tax which falls upon and is felt mainly by the poorer classes. It has ever been a favourite source of revenue with government which controls the supply of salt by manufacturing it itself and by taxing private manufacture and imports. It is one of the oldest taxes, and the duty is levied on all salt imported into and manufactured in India. The salt tax under British rule has had a long history and it has been the subject of prolonged discussion and experimentation[1]. The systems of government monopoly and licenses, have been tried in the different Provinces with varied results. As an outcome of this evolution, salt revenue is now derived from three sources, viz. (1) excise duty on Indian salt, (2) customs duty on imported salt and (3) sale of government salt. Salt works belong to government or are private property. In the first case, they are either directly managed by the State, as in Rajputana, or by private agency under government supervision. Excise duty is collected on all salt manufactured at private works. The customs duty on foreign imported salt and the excise on Indian salt are both fixed at the same rate. In 1882, the rate of the duty which had varied in the different parts of the country before that, was made uniform throughout India, at Rs. 2 per maund and was raised, six years later, to $2\frac{1}{2}$ rupees. Salt is a necessary of life in India, and a duty on such an article, it is generally agreed, ought to be light if it can not be dispensed with altogether. After 1903, on the persistent exhortation of the late Mr. Gokhale, the tax was steadily reduced and at last stood at Re. 1 per maund until it was increased on account of

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1 For an interesting history of the salt tax, read a "Monograph on Common salt" published by the Federation of Indian Chambers of Commerce and Industry.

the pressure of war conditions. In 1916, the duty was raised from Re. 1 to Re. 1¼ per maund and the increased rate was calculated to yield about £ 500,000 of additional revenue.

The facility with which the tax can be increased without trouble and change in the machinery of collection, is a temptation, which has, however, to be resisted. The fact that even a small reduction in the salt tax has immediately led to an increase in consumption shows the importance of this necessary of life to the poorer classes. The salt tax was regarded as a reserve of financial power to be drawn upon in times of need, and resembles, in this respect, the English income tax or the land tax in England before it was allowed to be redeemed. It is also supposed to be the only tax that reaches the poorer classes in the country who must be expected to make their own contribution to the expenses of the State. The fact that the tax is intimately associated with the daily life of the masses and the agricultural and manufacturing industries of the country, has not however been sufficiently attended to. The average annual salt consumption in India is estimated at about 5 crores of Maunds; that is to say, about 6 seers per head of the population. For every four Annas per maund, the revenue of government is Rs. 1¼ crore, so that when the duty is Re. 1 a maund, the State income is Rs. 5 crores.[1] Government has always taken the view that the rate of the duty, even when it is Rs. 2½ per maund, is so light that the opposition to it is the result of ignorance and is usually more political and sentimental than economic. In 1923–24, the increase in the salt duty to Rs. 2½ was effected by the exercise of the Governor General's power of certification and restoration of a rejected financial measure, the argument being that the balancing of the budget was a more important consideration than the worng-headed opposition to the increase in the rate. The duty was reduced to Rs. 1¼ in the following year. A further reduction of the tax has

1 In proposing to double the duty in 1922-23, the Finance Member said "The present consumption of salt in India works at about 6 seers per head of population. The increase of Rs. 1-4-0 per maund will, therefore, represent 3 annas per head per annum, or let us say, 12 annas per annum for each household of four. It can not surely be maintained that this will be felt appreciably by even the poorest classes. The extra revenue is estimated at 5 crores a year." The increase was obviously intended as much to reconcile the wealthy classes to their new burden as to secure a substantial accession to revenue.

since then been constantly pressed on government, and salt was the first object selected in the Gandhi movement of civil disobedience in April, 1930.

Apart from its purely political aspect, the salt tax has been recently discussed also on economic grounds. It is an anomaly that with India's unrivalled possibilities for the manufacture and supply of salt, the article has to be purchased by people at a high price and that it can not be utilised in agriculture and industries as freely as it should. India imports salt to the extent of Rs. $1\frac{1}{2}$ crores annually, particularly for consumption in Bengal and Burma where there is a keen demand for fine, white crushed salt, such as comes into the country from abroad. Salt is essential for the health not only of human beings but also of cattle and plants and is largely used in industrial processes such as fish-curing. It is not impossible to manufacture even the finer, imported variety in India and the Taxation Inquiry Committee recommended that the possibility of making India self-supporting in the matter of the supply of salt should be explored and that temporary protection should be granted to manufacturers to encourage them to bring about this result. The Government of India appointed an officer to inquire into the subject and the Board of Revenue concluded, as a result of the investigation, that no further measures than those already taken were necessary in the interests of the country. But Government was ultimately forced to refer the question to the Tariff Board.

346. Income Tax :—The Indian income tax has not been very productive and yielded only about Rs. 3 crores a year, until the rate was enhanced in 1916 on a graduated scale on incomes of and above Rs. 5,000. This is due to the fact that the people, taken as whole, are poor and the number of those who can be assessed is small. Besides this, income from land is exempted from the tax, as it has already to bear the burden of the land tax. Then again, those who would be subjected to a well-designed income tax, bringing into its net the wealthy, upper middle, trading and the professional classes and making them pay their due share, are influential people and can resist the imposition of such a tax on one ground or another. Sir John Strachey said :—" There is no country where a tax upon income is more just than in India, but there has been difficulty in imposing and maintaining it because it has been opposed by the richest and most powerful classes who alone can make their voices

heard. It has long been a reproach to our administration that they have borne no fair proportion of the public burden".[1] It was likewise felt for a long time that a tax on incomes as such was opposed to the genius and the traditions of the Indian people and that it was, therefore, not a suitable means of drawing State revenue. The small productivity of the tax, the administrative difficulties involved in its assessment and collection and the consequent failure of the early efforts to make it a permanent feature of the Indian financial system, gave point to the above view and it was exploited by the richer classes whose opposition was inspired mainly by self-interest. The experience of all countries shows the tendency of wealthy and influential classes to resist direct taxes and of democracy to favour them as against indirect taxes on necessaries.

The income tax in India has a long and chequered history. Under the rule of the indigenous powers, a tax on trades and professions was very common. The Visabadi tax, levied in the Ceded Districts of Madras, was assessed, even under British rule, in the aggregate on the principle of 10 p. c. on the profits of trade. The "Mohturfa" was similarly levied under indigenous rulers on the profits of persons exercising manual arts and professions. The Sepoy Mutiny had created a financial crisis and the situation was not unlike what it was on the close of the last War. A graduated license duty on trades and professions was proposed in the form of a bill before the Indian Legislative Council on 13th August, 1859 and the rates of the tax ranged between Rs. 2 and Rs. 2,000 annually.[2] In view of the appointment of Mr. James Wilson to be the first Finance Member of India, the progress of the bill was suspended, and Mr. Wilson introduced an income tax on the English model. The tax was to fall on all incomes above Rs. 200 a year, all incomes between that figure and Rs. 500 paying at the rate of 2 per cent. and incomes above Rs. 500 being assessed at 4 per cent. Incomes were divided into four classes: (1) derived from real property, (2) from trades and professions, (3) from the public funds, and (4) incomes from public salaries. Agricultural incomes e. g. those of Jamindars, were not to be exempted. The tax, however, proved unworkable and unproductive and a license duty on trades and professions was proposed partly to supplement it. The latter was, however, still-born. These

1 India, its Administration and Progress.

2 See the Author's "Dawn of Modern Finance in India," for an account of the first introduction of the tax.

taxes, which had to be collected in very small amounts from a large number of assesses, were harassing without being productive, and had soon to be abandoned. The old system of taxes on trades and professions was well suited to the simple and elastic form of government and administration that prevailed in those days; it could not be fitted into the rigid and complex British machinery of government.

The income tax was repealed after it had been in operation for five years and was replaced in 1867 by a License Tax which was the income tax in an improved form. It was, however, repealed next year and was substituted by the 'Certificate Tax', which was similar to the License Tax. It met with strong opposition from the wealthy classes and had to make room for the Income Tax of 1869. It remained in operation for four years and in 1873, the income tax was totally abolished. Provincial License Taxes were levied after 1876, and the Imperial government passed a License Act in 1880. Before the present income tax was first imposed in 1886, there had thus been in existence the license tax on professions and industries. The financial difficulties[1] of that year compelled government to devise new schemes of taxation. Import duties and a higher tax upon salt were not to be thought of, and government turned to the income tax as the only resource left to it. How strong was the opposition of powerful classes to an income tax, may be judged from the speech Sir A. Colvin made in the Viceregal Council on 4th January, 1886, in introducing the License Tax Amendment Bill. He said :—"The financial history of the last 25 years is strewn with the skeletons of discussions on direct taxation and more than one of my predecessors is gibetted on that dismal golgotha for the part which he took in connection with it...the classes in this country who derive the greatest security and benefit from the British Government are those who contribute the least towards it...I know that what I have said as to the immunity of the middle and upper classes from their due share of the public burdens is as a twice-told tale vexing the dull ears of a drowsy man; but it is nevertheless a grievous blot on our Indian administration which urgently calls for removal and which, I believe, with patience, prudence and exercise of a little fortitude must and will be removed."[2]

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1 See the Author's "Gokhale and Economic Reforms," Pages 14-15.

2 Proceedings of the Supreme Legislative Council, 1886.

347. Later Developments :—Under the stress of war conditions, government not only introduced the principle of progressive taxation into its income tax, but also imposed a super-tax in addition, on all incomes in excess of Rs. 50,000 per annum, on a graduated scale, an excess profit tax coming as a temporary war measure to enable the State to share in the huge profits made by a small section of the community out of the exceptional conditions of war time. In the budget for 1916–17, when at last the tax on incomes was increased, all existing exemptions were left untouched and no alteration was made in the taxation of incomes of less than Rs. 5,000 per annum. On the principle of graduation, tho following rates were fixed for higher incomes :—

From Rs. 5,000 to Rs. 9,999...6 pies in the Re. or 7½d. per £.
From Rs, 10,000 to Rs. 24,999...10 pies in the Re, or 12½d. per £,
From Rs. 25,000 and upwards...1 anna in the Re. or 1s. 3d. in the £.

The super-tax came in 1917 and began in respect of incomes exceeding Rs. 50,000 and was to be levied in an ascending scale as shown below :—

For every Rupee of the first Rs. 50,000 of the excess, *i. e.* between Rs. 50,000 and 1 lakh, 1 Anna per rupee,
For every rupee of the next 50,000 of excess, *i. e.* between 1 lakh and 1½ lakhs, 1½ Annas per rupee.
For every rupee of the next Rs. 50,000 of the excess, 2 Annas per rupee.
For every rupee of the next Rs. 50,000 of the excess, 2½ Annas per rupee.
For every rupee of the remainder of the excess, *i. e.* everything above Rs. 2½ lakhs, 3 Annas per rupee.

In 1921 the rate of the super-tax on Rs. 3 to 3½ lakhs was raised to 42 pies per rupee and to As. 4 for any excess over Rs. 3½ lakhs. The income tax rates for the higher incomes were similarly raised. A further rise was effected in 1922. The rate on incomes between Rs. 30,000 and 40,000 was raised from 14 to 15 pies and on incomes above Rs. 40,000, from 16 to 18 pies. The higher rates of the super-tax were likewise regraded and the highest rate was enhanced from 4 to 6 annas. The system of the assessment may be briefly explained thus :—" During 1923–24, Income Tax was charged on a graduated scale from 5 to 18 pies in the rupee, the latter being payable on annual total incomes of Rs. 40,000 or upwards. In the case of companies, registered firms and interest on securities, the tax was levied at the maximum rate. Annual income of less than Rs. 2,000 is not liable to the tax except in the case of companies, registered firms and interest on securities which are taxed whatever the annual total income may be. Super-tax is payable in addition

to income tax and is levied on a graduated and ascending scale on so much of the income as is in excess of Rs. 50,000 per annum. The rates of tax levied during 1923-24, varied from one anna to six annas in the rupee. In the case of a Hindu undivided family, the super-tax is levied on so much of the income as is in excess of Rs. 75,000. In the case of companies the super-tax is, however, levied at a flat rate of one anna.[1]" To bring the story of the tax up-to-date, it is necessary to mention the latest increase effected in the rates in order partially to cover the deficit anticipated for the year 1930-31. On personal incomes of Rs. 15,000 and upward, the rates were raised by 1 pie in the rupee and a corresponding increase was made in the super-tax in all grades, other than the flat rate of super-tax on companies. This increase was expected to yield Rs. 70 lakhs. In announcing this increase, the Finance Member expressed the hope of being able, if conditions were favourable, to introduce the principle of allowing business losses incurred in any one year to be carried forward to the next year and also to remove the existing double super-tax on companies, affecting genuine trust and finance concerns.[2]

The earlier increases in the rates of the tax on incomes were, of course, regarded as special war measures, but the new principle had come to stay. With increasing demands upon the national exchequer, those who were in a position to pay, had to make contributions to the expenditure of the State, proportionate to their means. If and when relief from the burden of taxation is granted, it must be granted to petty, resourceless land-holders whose agricultural incomes are taxed through land revenue and to the middle and the lower classes of consumers. Larger incomes, from whatever source they come, agriculture, industry or trade, have to make their reasonable contribution.[3] The income tax, like other taxes, is

1 Finance and Revenue Accounts of the Government of India for 1923-24.

2 Budget speech of Sir G. Schuster, 28th February, 1930.

3 When a resolution was moved in the Viceroy's Council in 1912, recommending that the minimum limit of income assessable to the income tax be raised from Rs. 1,000 to Rs 1,500 a year (the original limit of Rs. 500 had been raised to Rs. 1,000 in 1903 in Lord Curzon's time when the treasuey was overflowing with surpluses,), Mr. Gokhale laid down the following sound maxim :—" The State has to look at the whole scheme of taxation, first from the standpoint of its own necessities and secondly, from the standpoint of the comparative ability of the different classes to pay their particular share of the revenue raised from the community. Now, judged by this standard, I really do not think that the class for which my Hon'ble friend seeks a remission, has any substantial grievance."

now embodied in the annual Finance Bill, and the rates of assessment are varied annually according to the need of the exchequer. The Indian tax has, therefore, assumed the form of the British income tax. The consolidation and improvement of the legislation connected with it carried out in 1922 and the administrative and other changes since effected, are calculated to enhance the productiveness of the tax. But owing to the general economic depression prevailing in the country for the last few years, the yield of the tax has remained low instead of expanding.

348. Local Finance:—The financial position of municipalities and local boards has never been satisfactory. By the side of the central and provincial governments, these represent the third class of spending and taxing public authorities whose jurisdiction in this connection is restricted to the limits of cities, towns and rural areas and which are charged with certain special functions and endowed with appropriate powers.[1] These institutions were planted like foreign bodies in the midst of uncongenial surroundings and seldom breathed the air of independence. They were patronised and spoon-fed by the provincial governments and always suffered from financial weakness. It was very long felt that, to put life and vigour into them, they must be given growing sources of revenue and greater control over their own affairs, and it was clear that they would also have to increase their revenue by new taxes, additional rates or otherwise, if they were to discharge their functions efficiently. The duties of these bodies are mainly related to public health, convenience, education and safety and they affect the lives of the people most intimately. The total income derived from rates and taxes of all municipalities, of which there are about 750, is in the neighbourhood of Rs. 15 crores, and the total expenditure is more than double this amount, this difference being accounted for by the receipt of government grants and loans &c. The incidence of rates and taxes per head of the municipal population, which is about 19 million, is nearly Rs. 8. The municipalities of the big port towns account for 40 per cent. of the income and expenditure of these bodies and the other municipalities are, as a rule, very poor. District and local bodies have an annual income of about Rs. 11 crores and the incidence per head is As. 8. The

1 For an account of these local bodies read the Author's "Indian Administration."

condition of these local bodies is deplorable and their administration and finances will require earnest attention for years to come. Nearly one-third of their income is derived from the cess on land, and education claims more than that proportion of the total expenditure, civil works carrying off a pretty large slice of the income. There is a steady tendency towards increase in these figures; and the incidence of municipal taxation has considerably risen everywhere. Municipalities raise revenue by imposing octroi duties and house and water taxes; the local boards have the land revenue cess which is one anna on every rupee of land revenue, and there are other sources of income such as special cesses in Bengal, which are not very productive and elastic. The needs of sanitation, improved water supply and communications, medical aid &c., are very urgent and the well-being of the mass of the population depends on what may be spent on these reforms.

Local finance is a matter of great importance in other countries, and India has been exceedingly backward in that connection. Mr. Gokhale most successfully brought out this contrast in a speech he made in the Viceregal Council[1] in moving his resolution on the resources of Local Bodies. He pointed out that while in England, out of the total revenue, national and local, the share of local bodies was two-fifths, in India, it was only one-fifth, and more than one-half of that fifth was administered by the State itself. It is not possible for us here to enter upon a discussion of the principles on which functions of national and local governments are divided and of the several systems in vogue in different countries, with regard to the relation between national and local finance. There is no getting away from the fact, however, that the existing local bodies in India are, so to say, exotics which have not yet taken deep root into the soil, and the importance of reviving indigenous institutions like *Punchayats* has come to be recently appreciated. In the altered political and economic conditions it is not practicable to revive the old system of local government, and we can only pour new wine into old bottles and must harness the ancient spirit of local co-operation to the modern machinery of self-government. In whatever form we have those local bodies, they will succeed only if they are thoroughly popular, inspire confidence and generate enthusiasm. Functions like the provision of medical help and primary education,

1 13th March, 1912.

the promotion of public health, and the maintenance of communications will, in any case, have to be performed by them and they will succeed in the discharge of their duties to the extent they have funds to spend. The financial position of the larger municipalities is somewhat better, and they are spending steadily growing amounts on conveniences and amenities and are likewise raising more funds. But even they complain of the niggardliness of the contributions of the provincial governments, and the smaller municipal bodies are badly off.

349. Land and Local Finance:—Local bodies are at present severely hampered in their work by the paucity of resources, the latter being hopelessly inadequate to the efficient performance of their functions. Additional taxation is impracticable owing to the limited taxable capacity of the people, perticularly in rural areas. Land and other forms of property are the most suitable objects for local taxation. While income from land above a certain limit may, therefore, be taxed by the central or provincial government for national expenditure, local authorities should be allowed to levy a tax for their own purposes on land in their jurisdiction. Landholders benefit directly from services rendered by local bodies and they will manage the funds supplied by them to those bodies. In France, local authorities are allowed to add a rate to various national taxes for their own purpose and in Germany, they have their independent income taxes. In India, the land tax, with reductions in the case of very small cultivators, may be handed over to the local bodies as a tax upon property while a general income tax, which will fall upon agricultural as much as upon non-agricultural incomes, may be retained in their own hands by the central authorities.

This will sound as a revolutionary proposal, and sudden changes may be deprecated. We shall, however, be content if the principle of the position here taken up is accepted and the change is slowly wrought. The existing machinery for the assessment and collection of the land tax should be retained and the proceeds of the tax should be partly, if not wholly, assigned to local bodies. It may be repeated that the land tax should be a tax upon property or land values and moderate in its incidence, particularly so far as small holders are concerned, the larger agricultural incomes above a certain limit being assessed to the general income tax. The existing assessment

of the land tax may even be retained if a substantial portion of its proceeds is assigned to local bodies. The bulk of provincial revenue is derived to-day from land and when this is transferred to local bodies, the latter may be expected to perform such functions as are being performed for them by the higher government, grants paid out of provincial funds being then reduced or wholly withdrawn.

It has been already shown that the total burden of taxation in India is not light, but the distribution of land revenue between the provincial governments and the local bodies is most unsatisfactory. The indigenous village organization has gone to pieces and with it the old system of its finance. It should be noted that a large portion of the revenue of local bodies in other countries [1] is derived from land, and if local finance is to improve in India and the functions of local bodies are to be satisfactorily discharged, to the benefit of the mass of the population, we must progress along the lines followed by western nations. This will necessitate a suitable adjustment of the existing system to the needs of reform and the abandonment of the prevalent theories about land revenue. Local bodies have now been liberalized and powers of taxation have been conferred on them. The field over which this power may be exercised is, to-day, narrow, and will have to be widened before any substantial financial improvement can be expected.

350. Taxation Inquiry:—It has been shown above how important changes in the number, kinds and rates of taxes had to be introduced with the view of meeting the exigencies of the special conditions of the time of war, and it was to be expected that the tax-system should have become confused, uncoordinated, unequal and inequitable. As the abnormal conditions gradually disappeared, though there was still little prospect of the reduction of expenditure and of the fiscal burden, it was thought

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1 Mr. Gokhale says :—"In England the bulk of the contribution that comes from land goes to local bodies, the central government receiving only a very small amount as land tax. In France more than half the contribution from land goes to local bodies..........In this country, however, the division is in the proportion of 16 to 1, that is, sixteen-seventeenths goes to the state and only one-seventeenth to local bodies. Now there we have really a serious grievance...If we could get for our local bodies a much larger share of the contribution from the land, even if the proportion was not as high as in the West most of the financial troubles of those bodies will disappear."—Speech in the Viceregal Council.

necessary in 1923 that the whole position should be carefully examined in order to ascertain its defects and to lay down the lines along which improvements should be made as circumstances permitted. This is the genesis of the Taxation Inquiry Committee which was appointed in May, 1924, (1) to examine the manner in which the burden of taxation is distributed at present between the different classes of the population, (2) to consider whether the whole system of taxation, central, provincial and local, is equitable and in accordance with economic principles, and if not, in what respects it is defective, and (3) to report on the suitability of alternative sources of taxation. It is proposed here to refer only to the leading suggestions embodied in the Committee's report. The Committee was divided on the question of the nature of land revenue. It was, however, of opinion that "land revenue viewed as a scheme of taxation is not only not progressive, but actually tends in the opposite direction," and the results of this fact are aggravated by "the conspicuous absence of provision for an income tax on agicultural incomes or a death duty, which serve in the more advanced countries and Japan to introduce an element of progression into the taxation of the land." In order to secure in a scheme of temporary settlements the essentials of definiteness as regards the basis and the pitch of assessment, simplicity and cheapness, steadiness and ease of burden for the small cultivator and the introduction of the element of the principle of progression, the Committee recommended that for the future the basis of the settlement should be annual value, i. e. the gross produce less cost of production, including the value of the labour actually expended by the farmer and his family on the holding, and the return for the enterprise. The functions of the settlement officer are to be limited to the ascertainment of this value on a uniform basis, and a uniform rate, fixed for a whole province, is then to be applied to the valuations as they are made in districts falling in for resettlement. It is difficult to understand how, according to the recommendation of the Committee, the local legislature is to fix a common rate for the whole province, with its variety of local conditions, even though it may be guided by the results of an expert enquiry. Efforts recently made likewise to ascertain the "annual value" even in restricted areas, have failed to yield satisfactory results.[1] The Committee suggests, at

1 See Appendix to Chapter XVII above.

the same time, that the rate of assessment should be standardised at a comparatively low figure not exceeding 25 per cent. of the annual value.

The reduction in the share borne by the land revenue to the total taxation, must, in the view of the Committee, be accompanied by an increase in the local rate, the maximum for the ordinary rates being fixed at about 25 per cent. of the sum taken as land revenue. It is not possible to relieve the poorest cultivator by an exemption ; and relief of his difficulties is to be found only in a better system of rural economy generally. The obvious ways of introducing progression in the case of the large holder of land, are through an income tax on agricultural incomes or through something in the nature of succession duty, or both. With regard to import duties, some of them are protective in operation though they were not intended to be so. Other duties are restrictive in their effect on trade, and it appears that in the matter of import duties generally there is an amount of shifting of the burden from the richer classes to the mass of the population. A higher rate of duty can be safely imposed on wine, beer and spirits ; and a reduction of duties on conventional necessaries of life such as sugar, and on raw materials of industry and means of production, is desirable. An export duty should not be utilized for the purpose of protecting an industry. Duties on jute and rice should be continued, and that on tea should be touched only when it is proved to have detrimental effects on trade and industry. The duty on hides is wrong in principle and dangerous in its effects and must go, and that on skins should be kept and carefully examined. An export duty on lac is desirable and oil seeds and manures ought to be similarly treated. The present rate of salt duty is appropriate and causes no hardship. An excise duty on Indian-made cotton goods is not to be condemned if it is accompanied by an adequate customs duty and the burden on the consumer is not too great. The case for the reduction of the duty on petrol is not urgent; and if conditions are favourable, preference should be given to kerosene, as the burden of the tax falls on all classes of the population. Aerated waters are a suitable object for taxation, and so are patent medicines for an excise and an import duty. Cigarettes and pipe tobacco may be subjected to an excise though an excise on all production or an acerage duty are not practicable.

A number of suggestions are made with respect to the income-tax. A differentiation between earned and unearned incomes is not recommended in the present circumstances of India, and can be introduced when income from agriculture comes to be taxed like other incomes. A moderate increase in the rates applicable to incomes above Rs. 10,000 is regarded as equitable. It is suggested that the limit for super-tax should be reduced to Rs. 30,000 and that a new rate of super-tax of 6 pies on the first Rs. 20,000 or part thereof in excess of that sum be introduced. It is proposed that supertax on companies should be converted into a corporation profits tax, the exemption of the first Rs. 50,000 should be removed, and holding companies should not be assessed to this tax on profits representing profits of subsidiary companies. There is no historical or theoretical justification for the continued exemption from the income-tax of incomes derived from agriculture, but there are administrative and political objections to the removal of the exemption at the present time. A succession duty is impracticable in India, but a duty on the lines of the English Estate duty, which may initially take the form of a transfer or mutation duty on death, is more practicable. This involves representation of the deceased, which is desirable on other grounds. The existing law provides for it in certain cases, i. e. probate duty but is limited to particular communities. The taxation involved in this is very inequitable, and the committee recommends its modification and extension to all communities. It feels that the law of the joint Hindu family presents no insuperable obstacle, and it is suggested that the necessary legislation should be undertaken by the central legislature. It will be interesting to see how for the recommendations summarised so far, have been given effect to and are worth adopting.

351. Noteworthy Points:—We shall now give a brief summary of the important points which emerge from the above description of the Indian tax-system. The occasion will be utilised to direct the attention of the reader to the present situation and the immediate prospects as also to the principal recommendations of the Taxation Inquiry Committee. (1) The first fact that strikes the student is the increase which has taken place in the expenditure and the revenue of government in recent years. The pre-war figure representing these was roughly Rs. 125 crores for the whole country; and at present it is Rs. 210 crores, which means an increase of nearly 68 per cent. The revenue was

divided between the central and provincial governments in the ratio of 100:70. The revenue of the Provinces has not grown in the same proportion as that of the Government of India, being now about Rs. 80 crores as compared with Rs. 52 crores in 1913–14, an increase of 56 per cent. The spirit of retrenchment and economy has spent up its short-lived force; and in his budget speech on 28th February, 1930, the Finance Member plainly stated that there was little hope of reduction of expenditure while, on the other hand, new demands on the exchequer were being pressed. The Army expenditure which is now Rs. 55 crores as against Rs. 69 and Rs. 65 crores for the years 1921–22 and 1922–23 respectively, is still a little less than double the pre-war amount and the salaries and expenses of civil departments show a large increase over the pre-war years. It is necessary to repeat here that a comparison of the present situation with that of a few years ago must be made with great care as the factors of financial decentralization, price levels and the exchange value of the rupee, make important adjustments and allowances essential.

(2) The increased expenditure has been defrayed mainly out of the expansion of customs, excise and income tax revenue and also out of borrowings. Cutoms yielded $11\frac{1}{3}$ crores in 1913–14 and are calculated to yield more than Rs. 54 crores in 1930–31, the increase being largely due to enhancement of duties effected during the past few years and the high prices of commodities. Before the war, the Income Tax produced barely Rs. 3 crores; in 1930–31, it is expected that it will give Rs. 18 crores, thanks to the reorganization of the whole system of the tax, the imposition of the super-tax and successive increases in rates. The yield would have been much larger had it not been for the continued economic depression through which the country has been passing. The increase in the excise revenue is due to the higher prices of liquor and the increased license fees obtained by government. The popular agitation for prohibtion has borne little fruit and Provincial governments have been clinging to the drink revenue with pathetic attachment born of inability to find a suitable substitute. Revenue from customs duties will have to be conserved though anomalies of their incidence will have to be removed and relief will have to be given to consumers and to indigenous industries. Taxation of consumption has to be moderate in pressure, but it will not be a practical proposition to dispense with customs duties of a restrictive character for many a long year.

(3) The redistribution of the revenues of the Government of India and the Provincial Governments, is another feature that deserves notice. Provincial legislatures were not over-anxious to levy additional taxation, and the natural increase in the revenues of the Provinces was expected to satisfy the needs of development. Post-war deficits were indeed met with all-round retrenchment and increased taxation e. g. stamp duties and amusement taxes; but the scope for the expansion of provincial revenue is very small. The financial needs of the Provinces for schemes of development were urgent, and the central government having now dispensed with Provincial contributions, some of them, notably Madras and the U. P., have materially improved their financial position. The injustice done to Bombay in the transfer of its share of the income tax to the Government of India, however, remained unredressed. The Provinces have to work under the disadvantage that the limits within which they can levy additional taxation, are narrow while the cost of administration has increased under the reformed constitution and demands for additional public expenditure for economic development are insistent. Land revenue, excise, stamps, irrigation and forests which are the provincial sources of income, are not capable of appreciable increase and new avenues are difficult to discover.

(4) The improvement of local finance is a subject of equally great importance. The total receipts of local authorities in the United Kingdom in 1913, amounted to £ 200 million and thus equalled the total national revenue of the country. Of this, 41% represented receipts from rates. The aggregate revenues of all local authorities in India do not exceed Rs. 35 crores against a national revenue of Rs. 210 crores. The bodies in rural areas must be allowed to raise revenue from land and for this purpose, the present land tax will have to be handed over to them after the necessary readjustments are effected. The popularization of local self-government must go hand in hand with financial improvement in the case of the local bodies. The principle of decentralization of power, underlying the Reforms, is being applied to the local bodies and they are being endowed with increased authority and enjoy powers of taxation. The larger municipalities are better off, but the state of the others is unsatisfactory. The resources of the people of rural areas are admittedly small and political reform alone is not calculated to make appreciable addition to the revenues of local bodies. Taxes like a local

excise on tabacco, have been proposed but the suggestions are open to serious practical difficulties. The complaint is made that the people clamour for administrative improvements and want educational, social and economic reforms and that, at the same time, they strenuously oppose proposals for increased taxation. This disposition of the people, it is pointed out, is seen particularly in the municipal and local bodies and is represented as the real stumbling block in the path of progress.[1] It is certainly a fact that people resist additional taxes, but lack of means, education and of public spirit is responsible for the tendency. The resources of several municipalities have, however, been increased by means of additional taxation in recent years.

(5) The chief sources of revenue on which India must rely in the near future, will be customs—import and export duties—taxes on luxuries, higher rates on substantial incomes and taxes on large property to be levied on transfers and inheritance. An export duty on cotton has been proposed and it may, for a time, be paid by the foreign consumer owing to the keen demand for that Indian staple in Japan and elsewhere. Indian mills consume about one-half of the indigenous production, and an export duty of 5 per cent. may bring in two crores of rupees. Cotton is not, however, a monopoly of India in the way that jute is, and the incidence and the effect of such a duty will have to be carefully watched as it is likely to prove prejudicial to the Indian cultivator if India's customers secure their cotton supplies elsewhere. It is, therefore, a risky experiment one would not like to support. As regards direct taxes, efforts are already being made to improve the machinery and yield of the income tax, and its productivity has recently increased to a material extent. Though a poor country, India will have to develop a universal income tax, with suitable exemptions and deductions and a duty on inheritances.

(6) The land tax has reached the limits of productivity in all Provinces except in Bengal, and it is now claimed that its rate should be permanently fixed. Revision settlements which are accompanied by increase of assessment, are, therefore, being opposed almost everywhere. The bulk of the income tax revenue comes from a small number of wealthy persons, and the large majority of the assessees are people of moderate incomes. When the taxable mini-

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1 See "India in 1923–24".

mum was raised from Rs. 1,000 to Rs. 2,000 in 1919, for example, the concession gave relief to no fewer than 2,37,000 petty assessees out of a total of 3,81,000 persons who were assessed to the income tax before. Nevertheless, if the State wants more money, it has to devise an equitable system of taxation which will conform, as far as practicable, to the sound fiscal maxim that every member of the community should be made to contribute to the national purse in proportion to his ability which is to be gauged by the income he derives.[1]

Small incomes which can not be brought into the net of the central income tax, may be left to be dealt with by local bodies. As to inheritance taxes, large properties may be made to contribute to the exchequer, provincial or local, in proportion to their size. The principle of exemption of small properties and of graduation must, of course, be applied to inheritance taxes. The difficulties to be encountered in this connection are, however, great. Like income, property cannot be localized and there is danger of excessive taxation or evasion. The undivided Hindu families will be difficult to tackle for purposes of Death Duties. The indigenous law of succession governing the various communities and castes, will have to be carefully examined before any concrete proposals are put forward. The Taxation Committee has made certain recommendations on this subject. The principle that the property coming into the hands of a person by right of distant relationship with the deceased owner, is a fit object of taxation, will be universally accepted; but there will be serious practical difficulties in the way when it comes to actual application of the theory.

(7) Lastly, we may briefly refer to the question of "taxable capacity" of the people, which has been recently much discussed and which, in a way, we have already dealt with in ascertaining the burden of taxation in relation to the national income. Taxable capacity is found by taking the aggregate national dividend and deducting from it the amount which is required to maintain the community and its productive resources in accordance with the prevailing standard of living. The surplus left represents the margin the people have for paying taxes, and the proportion the actual amount of taxation collected bears to it, indicates the pressure of the public burden on the community. These calculations,

1 See L.G. Chiozza Money: "Riches and Poverty", Chapters XXI and XXII.

however, lead us nowhere and are often misleading.[1] In the first place, it is extremely difficult to ascertain the amount of income absolutely necessary to maintain a community and secondly, what is important is not the absolute but the relative capacity of the different classes of population. Thus it is not an enlightening conclusion to draw that taxation in India represents 30 to 50 per cent. of the surplus national income. Income assessed to the income tax indicates the size of the surplus and the number of people who have it ; and the poverty of the mass of the population is only too notorious. Village enquiries show that there are families which live below the standard which, even according to them, is essential for existence.[2]

The latest figures for the revenue and expenditure of the Government of India are given below :—

(In Crores of Rupees.)

Revenue.

Heads	Accounts 1928–29	Budget Estimate, 1930–31
Principal Heads		
Customs	49·28	54·47
Taxes on Income	16·70	17·99
Salt	7·59	7·04
Opium	3·26	2·71
Other Heads	2·23	2·30
Total Principal Heads	79·08	84·55
Railways : Net Receipts	37·48	38·10
Irrigation : Net Receipts	·9	·14
Posts and Telegraphs : Net Receipts	2·80	3·45
Civil Administration	1·00	1·06
Currency and Mint	2·88	2·89
Civil Works	·17	·26
Miscellaneous	·89	·86
Military Receipts	3·39	3·62
Provincial contributions and adjustments	·3	...
Extraodinary Items	1·04	·32
Total	128·98	135·48
Deficit	·31	...
Grand Total	129·29	135·48

Expenditure.

Heads	Accounts 1928–29	Budget Estimate, 1930–31
Direct Demands	4·02	4·35
Forest and other capital outlay	·3	·6
Railways : Interest and miscellaneous	32·25	32·36
Irrigation	·22	·25
Posts and Telegraphs	·81	·92
Debt Services	15·62	17·81
Civil Administration	11·43	13·29
Currency and Mint	·71	·77
Civil Works	1·59	2·81
Miscellaneous	4·05	4·16
Military Services	58·49	57·97
Miscellaneous adjustments	·1	...
Extraordinary Items	·1	·05
Total	129·29	134·78
Surplus	...	·70
Grand Total	129·29	135·48

1 See G. Findlay Shirras : *Science of Public Finance* and Brij Narain : *Indian Economic Life.*

2 See Dr. H. H. Mann : *Life and Labour in a Deccan Village.*

The financial position of the Provincial governments will be dealt with at the close of the next chapter. Here it will suffice to say that the complete remission of contributions to the central exchequer has improved the revenues of Provinces like Madras, U. P. and the Punjab which are Rs. 18, 13 and 13 crores respectively as against Rs. 14½ crores and 11½ crores for Bombay and Bengal, Behar and Orissa and C. P. have about Rs. 6½ and 5½ crores as their annual revenue. The disparity between the Provinces as to their relative populations and revenues is extremely striking, and constitutes one of the most difficult problems in Indian federal finance.

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CHAPTER XIX.

PUBLIC FINANCE.

352. Capital Expenditure:—The science of public finance deals with the principles and methods relating to the acquisition, collection and expenditure of the funds necessary to enable governments, national, provincial and local, to maintain themselves and to discharge their appropriate functions.[1] In the last chapter, we covered one important portion of the domain of public finance in India, viz. the system of taxation. The State budget displays characteristics similar to those of a family budget, and besides the regular expenditure, it has to provide for the requirements of its commercial undertakings and for needs of an extraordinary nature. It is now proposed, therefore, to survey the other parts of the field of finance and to deal with the broader aspects of the subject, e. g. the financial relations between the central and provincial governments, capital expenditure on public works like Railways and New Delhi, public debt, floating, temporary and permanent, sinking funds &c., which raise problems of a nature different from that of questions treated in the last Chapter, though the two subjects are very closely related to each other. Attention is also invited to our discussion of government balances, ways and means programme and allied topics in the chapters on currency, exchange and banking. The first problem which has taxed the brains of government for three quarters of a century, in this connection, refers to the capital required for Railways. Mention has already been made of the system of providing capital, prevailing in per-war years. The Acworth Committee laid stress on the necessity of making a definite and reliable provision for funds required by Railways; and its recommendations were designed to ensure that result. Arrangements in this behalf before the War were declared to have been unsatisfactory. During the war-period capital ex-

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1 Fancesso Nitti: *Principes de science des Finances*; and *Handbuch der Finanz wissenschaft*, Erster band.

penditure on Railways had to be reduced and they had to be worked at a high pressure. Railway capital expenditure on State-owned lines, open lines and lines under construction, amounted, therefore, to comparatively very small sums, and the provision could be increased only after the close of the war, as may be seen from the following statement :—

Capital Expenditure on State Railways.

Year	Open Lines			New lines Rs. (crores)	Grand Total Rs. (crores)
	Works including stores Rs. (crores)	Rolling Stock Rs. (crores)	Total Rs. (crores)		
1913–14	9·30	7·31	16·61	1·86	18·47
1919–20	9·28	4·56	13·84	0·21	14·05
1920–21	14·93	10·13	25·06	1·02	26·08
1921–22	11·20	10·02	21·22	2·11	23·33
1922–23	6·77	9·52	16·29	2·74	19·03
1923–24	7·69	9·51	17·20	2·51	19·71
1926–27	16·74	4·13	20·87	6·27	27·14
1927–28	17·21	5·37	22·58	9·86	32·44

On the close of the war, financing of railways on a generous scale was resumed, and the bulk of the capital made available was utilised for making up the arrears of repairs and renewals neglected during the war period. In consonance with the recommendations of the Railway Committee, it was decided to spend out of capital Rs. 150 crores in the course of five years; and Rs. 30 crores were provided in the budget for 1922–23. The estimate of the strain that would be put upon the railways by the rapidly growing volume of traffic did not, however, materialize owing to the general economic depression. The actual sums expended on capital account in 1925–26 and 1926–27 were Rs. 19.24 crores, 27.14 crores respectively. The amounts for the next three years were sufficiently large viz. Rs. 25 crores on the average. But in 1929–30, no more than 24 crores were available, and in the budget for 1930–31, the capital

allotment had to be cut down to Rs. 16.7 crores only. Financial stringency and the high rates of interest ruling in the world money market adversely affected the borrowing power of the Government of India and therefore put limits on the capital programme of the Railways. A separate Railway budget, it is clear, does not provide for independent and liberal borrowing and capital expenditure for Railways which have to adjust their programme of outlay to the general financial position of the government.[1]

353. Separation of Railway Finance :—It is worth considering, therefore, whether one of the principal objects of the separation of Railway finance, viz. undisturbed prosecution of capital schemes by the Railway administrations, has been fulfilled. The view was held by some that profits from railways, which by their fluctuation and uncertainty, disturbed the even course of national finance and were not the proceeds of taxation, should not form part of the ordinary current revenue of the country, but should be set apart for being laid out on the expansion and improvement of railways, so that the annual borrowings of capital would be substantially reduced and the dependence of railways on annual budgets would be minimised. Others were, however, inclined to hold that railway profits which were earned not only after meeting all charges on account of interest on the total amount of capital borrowed for railways but after providing for annuity and sinking fund charges as well, were a legitimate source of revenue to the State and that the tax-payers were entitled to receive the relief thus afforded to them.

Separation of the Railway budget from the general national budget was strongly urged by the Indian Railway Committee. It was contended that apart from the element of uncertainty introduced into the annual financial estimates by the inclusion of railway profits therein, the dependence of railway finance on the exigencies of the general budget and the needs of the exchequer, impeded the capital programme of railways, interfered with the execution of essential repairs and renewals and caused waste and ultimate loss. The Committee observed :—"and the essence of this reform is con-

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1 " But financial exigencies have made retrenchment inevitable..." " It is in connection with the capital programme that the operations of the Railway Department chiefly affect the general finances of the Government of India, and in any review of policy the Finance Department must take its full share."—**Railway Member's Budget speech, 1930.**

tained in two things : (1) the complete separation of the Railway Budget from the general Budget of the country and its reconstruction in a form which frees a great commercial business from the trammels of a system which assumes that the concern goes out of business on each 31st of March and recommences *de novo* on the 1st of April ; and (2) the emancipation of the railway management from the control of the Finance Department." The Committee passed severe strictures against the inadequacy of funds provided by the Finance Department for the maintenance and renewals of railways and condemned its financial methods as absolutely unbusinesslike. The principle on which the railways must be managed was stated by the Committee to be that 'by the time the useful life of an asset or a building has expired, its full original cost should have been written off out of revenue. This has not been the case on the Indian railways. There are scores of bridges with girders unfit to carry train loads up to modern requirements...Their cost has not been written off. They stand in the books at the original figure. The Government has formed no replacement reserve.'

The Committee's trenchant remarks directed against the dilatory and unbusinesslike financial methods of government and its arguments in support of the separation of the Railway budget, will be widely appreciated.[1] The Committee was, however, on debatable ground when it proposed that the Railway business of the State should pay out of its earnings only the interest on capital and should make no contribution to the national exchequer as a rule. It asked the public to be content with the economic and social benefits railways had conferred on the community and the improvement in State revenue they had indirectly brought about. But if railways are a business, it is pertinent to inquire, for whom do they exist ? Are not those who have paid for them out of taxation for years, to expect any profit out of them ? For, it must not be forgotten that railways have now become remunerative only

1 "The primary function of any such Department (the Finance Department) is to reduce to a minimum expenditure in order to keep at the minimum the corresponding taxation. Its officials are not qualified either by training or experience to judge the essentially commercial and technical question when and where the circumstances of a railway undertaking justify bold expenditure of large sums, having regard not merely to the actual conditions of the physical machine at the moment, but to the prospects of development and the requirements of the future."

after having taken year after year, a crore of rupees a year on an average for fifty years; and it is but just that the profits should go to relieve the burden of the tax-payer so far as this can be done without detriment to the position of the railways, which are, after all, a commercial undertaking.[1]

354. Separation and After :—Though the Acworth Committee did not approve of the contribution by the Railways to the exchequer of any thing more than the annual interest on the debt incurred by the State for railway purposes, it was careful to point out that the separation of the railway budget was not dependent on the acceptance of that particular view. The financial situation, again, was not so very favourable that the exchequer and the tax-payer could contemplate the proposed sacrifice of revenue with equanimity. Government, therefore, suggested to the Legislative Assembly a scheme in which "the railway finances shall be separated from the general finances of the country and the general revenues shall receive a definite annual contribution from railways which shall be the first charge on railway earnings." It looked only fair that the railways should not be saddled with the payment of interest on the capital expenditure on strategic lines and the repayment of capital borrowed. The scheme of Railway contribution finally adopted by the Legislature in 1924, has been briefly described on a preceding page.

The fundamental idea of the scheme of the separation of the railway budget was that the railways should be given an opportunity to develop themselves along business lines with the power to utilize their resources to the utmost, only subject to the obligation to make a fixed contribution to the national exchequer. They were expected to build up a reserve fund and to provide for depreciation. About 11 crores of rupees a year were credited to the depreciation fund by debiting the amount to revenue on that account, in 1926–27 and 1927–28, and very nearly equal sums were taken out of the fund for expenditure on replacements and renewals. For 1930-31, the opening balance of the Depreciation Fund was Rs. 12·5 crores, and Rs. 13·2

1 In this connection, we wrote in our fourth edition of this book: "If the railway budget is not to be disturbed by the needs of the general budget, why should the railways not make a fixed annual contribution to the national exchequer on a scale to be determined say every five years?"

crores were to be added to it by appropriation in the year. Rs. 8·5 crores were to be taken out for expenditure and the closing balance was expected to be Rs. 17.2 crores. The Reserve Fund stands at about Rs. 18 crores. The power of financial control vested in the Legislative Assembly was kept intact under the schme of separation, and it was desired to create a convention that the details of the railway budget should not, as far as possible, be interfered with, the railway budget continuing to be discussed, criticised and voted upon as before.[1] Railway finance was not to be considered from the point of view of the position of a brief period of only one year but was to be surveyed with an eye to economical and efficient management over a series of years. Though the scheme of financial separation initiated in 1924, may be said to have worked well, on the whole, adverse criticism on its operation has been frequently given expression to in the Legislative Assembly. Questions have been raised as to whether the Finance Department exercises sufficient control over Railway expenditure in the interest of national credit and economy, whether the Railway contribution to general revenues is anything more than a provision for the sinking fund for the railway debt and whether railway profits ought to go to benefit trade and industry rather than to relieve the tax-payer. It will thus be seen that the whole problem of Railway finance and its relation to general national finance, in its fundamental aspects, here comes up for reconsideration, and it looks as if the scheme initiated in 1924, must be re-examined and revised in the light of recent experience.

355. Era of Deficits :—One striking feature of war and post-war finance is the enormous increase which took place in the public debt of the country. The economic depression which overtook India along with other countries, in the place of the industrial and commercial prosperity which had been anticipated on the close of the war, was the cause of serious financial trouble. The revenue of government did not rise to the expected level while the expendi-

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1 "The reform proposed will bring us valuable dividends in our future budgets and at the same time lead to great economies in the working of our Railways. It will give them real incentive to increase their efficiency and to provide better service at reduced cost to their customers, the Indian public...The Government of India and this Assembly will remain in complete control of the Railway Administration as they now are:"—Speech of Finance Member in introducing the Budget for 1924-25.

ture remained at a high pitch. Deficit, therefore, succeeded deficit, and the revenue fell short of the expenditure by no less an amount than 90 crores of rupees in four years. These gaps were filled with borrowings in various shapes when they could not be covered with additions made to taxation. Rs. 19 crores of new taxation were added in the budget of 1921–22 —a record addition for a single year—and yet government was confronted with a still larger deficit of 32 crores in the next year. The financial position was almost desperate, and in spite of another big addition to taxation, a considerable portion of the deficit had to be left uncovered. We shall give a few important details. There was a deficit of Rs. 6 crores in 1918–19 and it was left uncovered. In 1919–20, largely owing to the Afghan war, the deficit increased to Rs. 24 crores; and in 1920–21, the deficiency rose still higher and reached Rs. 26 crores. The year 1921–22 was one of the most adverse, and witnessed a deficit of Rs. 33 crores. The next year, 1922–23, was estimated to close with a deficit of Rs. $31\frac{3}{4}$ crores, and government could propose to find Rs. 29 crores by additional taxation and had to leave the deficiency of Rs. $2\frac{3}{4}$ crores uncovered. The accounts of the year 1922–23 actually showed a deficit of Rs. 15 crores, the increase being partly due to the refusal of the Legislature to consent to the doubling of the salt duty proposed by the government.

The recurring deficit appeared to be a bottomless pit which could not be filled up by the growing amounts of taxation which were thrown into it. The legislature and the public felt that the situation must be met with a determined effort at drastic retrenchment. The Geddes Committee in England became a model for this country, but the Government of India was unwilling to allow an outside body to apply the axe to its bloated expenditure. The government professed great anxiety for economy and the reduction of the expenses of administration and offered to put its house in order without the scrutiny of a committee. But the two Houses of the Legislature insisted upon a thorough-going investigation by an external body and government was compelled to appoint the Inchcape Committee, in May, 1922. The report of this Retrenchment Committee was out in March, 1923 and some of its recommendations were made in time to be incorporated in the budget for 1923–24. The Committee recommended a total retrenchment of Rs. $19\frac{1}{4}$

crores in the expenditure of the Government of India, the military department coming in for the largest share, viz. Rs. 10½ crores. Railways were expected to make a cut of Rs.4½ crores, and Rs. 1⅓ crores was the amount of the cut suggested for Posts and Telegraphs. The budget for 1923-24 included considerable reductions on the lines recommended and yet the revenue was estimated to lag behind the expenditure by Rs. 9 crores. Government proposed to bridge the gulf by doubling the salt duty which the legislature would not assent to, and the Governor General had to exercise his special powers to give effect to the proposal. In the 1924-25 budget, the era of deficits was left behind and the Finance Member was in the embarrassing but happy position of being called upon to dispose of an estimated surplus of Rs. 3⅓ crores. The latter was utilised in reducing the salt duty to Rs. 1¼ per maund and the reduction of Provincial contributions had to wait for one more year. The total remission of these contributions was a heavy obligation resting upon the central government, but subject to it, surpluses began to accrue in the central exchequer once more, from the year 1924. The years 1929 and 1930 were unfavourable years, and the two sides of the budget for 1930-31 could be squared only by additional taxation.

356. Financial Decentralization :—The Government of India was, for generations, wedded to the system of centralisation, and its rigid control over the provinces has been slowly and almost reluctantly relaxed in favour of local governments; but the introduction of responsible government in the provinces under the scheme of the "Montford" constitutional reforms, required the complete separation of the sources of revenue of the two governments and the substitution for assignments of Imperial revenue to provincial governments, contributions from the latter, if necessary, to the exchequer of the central government. Though the provincial governments in India did not occupy the same position as the constituent states of federated nations like the U. S. A., the progress of this country was not calculated to be rapid unless financial independence was granted to the Provinces. Owing to historical causes among which the chief was the constitution, by the Regulating Act of 1773, of the government of Bengal as supreme over the other presidencies, Government of India's policy had always been, and it was more marked before Lord Mayo's reform of 1871, to regard its exchequer as the one national exchequer of

India and to treat provincial governments as subordinate authorities who were to collect and spend funds that were to be assigned to them. For over two generations a slow development took place in the direction of provincial decentralization, but provincial governments could neither tax nor raise loans independently. In the place of fixed lump assignments, they were given, under quinquennial contracts which were made almost permanent in 1911, shares in certain growing sources of revenue but they had little interest in improving these sources and in practising strict economy so long as they were under the rigid control of the Government of India.

This state of things had to make room for a system under which provincial governments had independent sources of revnue and there were no divided heads as under the traditional arrangements. For instance, customs, the income tax, railways, the post office, salt and opium could be entirely Imperial, while land revenue, excise, stamps, irrigation and forests could be wholly provincial. Military, naval and other charges had to be borne by Imperial revenues, and the Provinces would make contributions to them on certain fixed principles if the resources of the central government proved inadequate. The reform was suggested several years ago, but we move very slowly in this country. The grant of fiscal autonomy to the Provinces and the readjustment of the financial relations between the central and provincial governments could not, however, be long delayed, and became inevitable. As, under the Montague-Chelmsford reforms, provincial governments were given greater powers and the provincial legislatures a larger measure of control, and the relations between the government and the people become closer, decentralised finance and provinicial taxation became imperatively necessary.

In the course of the evolution of the financial relations between the Government of India and the Provincial Governments, the latter had come to secure shares in growing sources of revenue, and the quinquennial contracts about those shares, had been converted in 1904 into quasi permanent agreements. The new system was free from some of the conspicuous evils of the old one, viz., the quinquennial revisions of the contracts, the raids made by the Government of India on the provincial resources and the scramble among the local governments for larger assignments of revenue. Still the governments had no power of levying taxation and of borrowing on

their own account, and the 'doles' which the central government gave to them out of its surpluses, proved inconvenient. The introduction of partial responsible government in the provinces and the grant of a large measure of autonomy to the provincial governments, necessitated a wholesale re-arrangement of the financial relations on the lines of federal organization towards which the country had been imperceptibly moving. In their report on constitutional reforms, Mr. Montague and Lord Chelmsford, therefore, proposed that the Imperial and the provincial sources of revenue should be entirely separated, that land revenue which was every where a shared head, and irrigation and excise wherever they were divided, should be provincialized and also receipts from judicial stamps. The income tax and receipts from commercial stamps were to be handed over to the Government of India to supplement the entirely Imperial sources of revenue such as customs, railwey receipts, salt and opium.

This redistribution of resources was, however, calculated to leave a deficit in the Imperial exchequer and it had to be made good by contributions out of the corresponding gains made by the provincial governments. It was calculated that on the budget figures for 1917–18, the Imperial deficit would amount to Rs. 13·63 crores; and this amount was to be distributed over the provinces, each contributing 87 per cent. of its gross surplus accruing under the proposed scheme. This arrangement did not, of course, presume to remove the inequalities that existed as regards the financial contributions and sacrifices that Provinces had to make in different proportions to their revenues. Powers of independent taxation and borrowing were likewise to be conferred on the Provinces, to be exercised within obvious limits required by the peculiar relations in which they stood to the central government.

357. Meston Committee's Award :—The scheme proposed in the Joint Report was not received with favour; and on the recommendation of the Joint Select Committee of Parliament which considered the Reform Bill, the Secretary of State appointed the Meston Committee to give advice as to the provincial contributions to be made to the Imperial exchequer and allied questions. Owing to the savings which the Government of India was able to make in its expenditure, through a high rate of exchange, its contemplated deficit had been reduced from 13·63 to 6 crores. But the Meston Committee increased this amount to about Rs. 10 crores by proposing

the provincialization of the revenue from General Stamps and with slight adjustments, it proceeded to discover a formula for distributing the amount of this deficit among the Provinces. It sought to fix the 'initial contributions' which would, in the course of seven years, become 'standard contributions'.

The Committee could not conceal from itself 'the disadvantages, in ordinary circumstances, of a system of provincial contributions' and anticipated that 'the Government of India will direct its financial policy towards reducing those contributions with reasonable rapidity and their ultimate cessation.' It was provided later that disposable revenue surpluses in the central exchequer should be used to reduce provincial contributions in a given order in accordance with fixed ratios, Provinces with larger obligations, of course, receiving precedence in this relief. But it could not devise a suitable method for redressing the grievance of a province like Madras about a proportionately larger portion of the revenues contributed by its people, being assigned to the Imperial exchequer. For doing justice to Madras, it could not reasonably leave other Provinces to levy additional taxation to finance their normal requirements. The Committee examined various basic principles suggested for distributing the Imperial deficit, such as provincial revenue, population and expenditure and hit upon the plan of assessing provincial contributions upon the amounts of 'additional spending power' acquired by the Provinces through the redistribution of their sources of revenue. Its recommendations were summed up in the followiug table :—

In lakhs of Rs.

Province.	Increased spending power under new distribution of revenues.	Contribution as recommended by the Committee.	Increased spending power left after contributions are paid.
Madras ...	5,76	3,48	2,28
Bombay ...	93	56	37
Bengal ...	1,04	63	41
U. P. ...	3,97	2,40	1,57
Punjab ...	2,89	1,75	1,14
Burma ...	2,46	64	1,82
Bihar and Orissa ...	51	...	51
C. P. ...	52	22	30
Assam ...	42	15	27
Total ...	18,15	9,83	8,67

358. Provincial Contributions:—In making its recommendations, the Financial Relations Committee had to take care to see that no province was started on its career of financial autonomy with a deficit budget or with the immeditate necessity of additional taxation. It had, therefore, to impose a higher contribution upon Provinces like Madras, U. P. and the Punjab whose gains were comparatively extensive, and thus to give room for dissatisfaction and protest. The government and the people of Madras, for instance, strongly disapproved the proposal that their province should be made to contribute Rs. 3·48 crores out of the Rs. 5·76 crores which was the increased spending power secured by it. The initial contribution on Madras was to be 35½ per cent. of the total Imperial deficit against the 5½ per cent. of Bombay and 6½ per cent. of Bengal. The contributions of the last two Provinces were smaller obviously because their revenue gains under the scheme of financial redistribution were smaller. The complaint of Madras was that the unequal and the unjust treatment which had been meted out to the province for years, was going to be perpetuated. With a population twice as large as that of Bombay, Madras had to be content with revenue and expenditure which were not much larger than those of the western Presidency. And under the proposed scheme, the burden imposed upon it, was again heavier. While this was the ground of the Madras protest, Bombay had a grievance of its own. It had reference to the proposal of the Meston Committee that the entire proceeds of the income-tax collected in Bombay should be transferred to the exchequer of the central government.

The Committee was swayed in its decision to hand over the whole of the income-tax receipts in the Bombay Presidency, to the Imperial exchequer by various considerations among which the chief were the high level of the cost of administration which had been attained there, the long strides with which its revenues had advanced during recent years and the industrial and commercial wealth and the enterprise of the people of the Presidency. Curiously enough, these very reasons were strongly urged against the Committee's suggestion. It was contended that the tax on incomes was the only means the Government of Bombay would have to tap the wealth of the people, that land revenue and excise had already reached the limits of productivity and that the development of the Province was bound to be seriously retarded if the income-tax was handed over to the central government. Strong

protests from Madras and U. P. poured in on the central government, and part remission of their contributions and a reconsideration of the whole question were demanded. But the financial position of the Government of India was too bad to permit any remission; and the rate of exchange on which the calculations were originally based, having proved unfavourable, the solution of the problem became most difficult.

Strenuous efforts were made by the Provinces which felt aggrieved by the Meston award, particularly by the governments of Madras and Bombay, to secure a substantial reduction of their contributions and a revision of the whole scheme. The Government of India took up the attitude that they would begin to give effect to the arrangements proposed by the Meston Committee as soon as there was a surplus in the central budget. The resolutions moved in this behalf in the Indian legislature by private members, were turned down on the above plea and created a division of opinion in the Assembly on account of the fact that Bombay was anxious to have the whole question reopened and was not interested in the reduction of provincial contributions. The Finance Member was in a happy position when Provinces did not agree and he played his cards skilfully in confronting the legislature, every time he got the opportunity to do so, with the alternatives of the reduction of the contributions, lowering of the rate of the salt duty and the abolition of the cotton excise. The reduction of the rate of exchange to 16d. which increased the central government's expenditure on payments in England, was added to the list of excuses to put off relief to the Provinces, later on. The budget for 1924–25 was calculated to yield a surplus of Rs. 3·36 crores and ths Finance Member proposed to devote Rs. 1·82 crores to the reduction of the salt duty from Rs. 2½ to Rs. 2 per maund and Rs. 1·5 crores to the reduction of provincial contributions. But the Legislative Assembly would have no compromise on the question of the salt duty in spite of the bait of the relief to the Provinces; and Lord Reading had to certify the Finance Bill in the minimum form which, he felt, the responsibility vested in him dictated. The salt tax was thus reduced to Rs. 1¼ and the reduction of Provincial contributions was postponed. As the financial position steadily improved and the rate of exchange was raised, it became practicable to reduce the contributions and in the end to forego them altogether.

359. Public Debt :—We shall now give a brief account of the Public Debt of India. At the outset, we have to emphasise one

peculiarity of the Indian debt viz. that its burden was slight in pre-war years and was almost negligible till it was increased by India's war contribution of Rs. 150 crores to the Imperial government and by recurring war-time deficits. While the public debts of European countries ran into millions of pounds, chiefly owing to wars, the bulk of the Indian debt, it should be noted, was mainly contracted for productive purposes. It must not, however, be forgotten that in the past we have paid off our unproductive debt out of revenue at great sacrifice. India has had her dead-weight debt incurred for wars military expeditions beyond the frontier, warlike preparations and for meeting famine expenditure and deficits. But whenever there were surpluses they were systematically used for reducing the public debt, which means that the Indian tax-payers have had their burden of debt paid out of tax-money.

In the time of the East India Company, political and commercial functions of the State were mixed up together. The continued wars which the Company had to undertake, went on adding debt to debt steadily from year to year though a part of the deficit was supplied from the commercial profits of the Company. The British acquisition of India cost England nothing and was secured out of Indian resources; and the cost of the conquest was the main cause of the growing public debt. The total 'territorial' debt of India in 1792 was £ 7 millions and increased to £ 30 millions in 1829, to more than £ 51 millions by the middle of the 19th century, and to £ 69½ millions in 1858. The Mutiny made huge additions to the public debt, and it went up to about £ 129 millions in 1876. The debt stood as follows during the subsequent years:—

I

India's Public Debt.

31st March.	In Sterling. Mill.	In Rs. 15 Rs.=£1. Mill.	Total £ Mill.	Interest. £ Mill.
1888	84·1	65·4	149·5	6·2
1893	106·7	68·6	175·3	6·7
1898	123·8	74·4	197·8	6·7
1903	133·8	78·2	212·0	7·1
1908	156·5	88·5	245·0	8·1
1913	179·1	95·2	274·3	9·5

The 'ordinary' or unproductive debt was gradually reduced and the productive and unproductive debts are distinguished in the following table:—

II

Ordinary and Productive Debt.

	Ordinary.	Productive (Mill £.)			Total
31st March.	Mill. £	Railways.	Irrigation.	Total.	Mill. £.
1888	73·0	59·2	17·3	57·65	149·5
1893	65·0	61·0	19·3	110·3	175·3
1898	70·0	106·0	21·7	127·7	197·7
1903	59·1	128·1	24·8	159·2	212·0
1908	37·4	117·7	29·9	207·6	245·0
1913	25·0	211·8	37·5	249·3	274·3

Unremunerative debt shrank in 20 years from being $\frac{1}{2}$ to $\frac{1}{11}$ of the total volume of outstanding loans. The reduction reflects approximately the extent to which current revenues have been devoted to capital expenditure. There was a sort of sinking fund arrangement by which to reduce the unproductive debt, while for the redemption of the productive debt, provision was made for annuities &c. in the railway expenditure. Interest charges debited to railways, contained items of this description, so that the true or gross profits from the railways were higher than those shown in the accounts. In any year in which, owing to the use of surplus revenue or deposits for the construction of public works, the capital expenditure of the year exceeded the amount of debt incurred in the year, the effect of this system of classification (Ordinary and Productive Debt) was to cause a decrease to be shown in the amount of the ordinary debt.

The Permanent Public Debt in India and England, was distributed during war-years, among the different forms as follows:—

Millions of £.

31st March.	Ordinary.	Railways.	Irrigation.	Total Railway and Irrigation.	Grand total.
1913	25·0	211·8	37·6	249·4	274·4
1914	12·8	222·0	39·4	261·3	274·2
1915	2·2	233·2	41·1	274·3	276·5
1916	2·0	234·4	42·4	276·8	278·8
1917	3·7	235·7	43·3	279·0	28[illegible]·7
1918	67·2	239·1	44·0	283·1	350·3
1919	47·0	243·7	44·5	288·2	335·2

Government raises, for its capital programme, rupee loans in India and sterling loans in England, and for purposes of railways, the latter were found necessary as sufficient amounts could not be raised in this country. While exchange was unstable, sterling borrowings entailed a heavy charge; that difficulty was later on removed. It was, of course, still desirable to raise as much capital in India as possible. Construction and maintenance of railways required, according to the high standard laid down, large amounts which could not be secured in this cuntry, and the amount of interest that had to be paid to England, increased year after year. The War Loans were, of course, extraordinary debt and though their success was gratifying so far as it went, the total obtained by government out of the Rs. 150 crores of the war-gift, showed the poverty of the country compared with the abundant wealth of other nations. The success of recent loans has, however, been gratifying, and indicates that all the capital required by government is capable of being raised in this country.

360. War Loans:—The fact that the response of the people to the appeal from government for the first War Loan, exceeded all expectations and reached £ 36 million, taught the lesson that if her resources, limited as they are, are properly tapped, India is capable of yielding large amounts as a contribution to the Public Debt. The War undoubtedly brought copious funds into the hands of several persons, and such abundance of loanable capital will not be a feature of peaceful times. Special appeals made to the patriotism and the pockets of the people at that time can not likewise be repeated. But it is hoped that Indian people will be able in future to satisfy the annual capital needs of government and that it need not look to London for loans. This will be an eminently desirable development as it will save a steadily increasing amount of money from going out of the country, in the form of interest to outside investors, and will stimulate saving and investment by the people in India. The Cash Certificates carrying a good rate of interest and encashable at any time, were issued through the Post Office and were a novel feature of the war loan of 1917.

It was realized that the existing system of attracting public contributions to the national debt was capable of improvement as regards simplicity and convenience. The usual formalities were,

therefore, reduced and people were induced to invest in the war loans through the Post Office and there were also long and short time securities offered. The amounts obtained in 1917 were as follows :—

		Million £
Main Loan	... ...	26·6
Postal Section	... ...	2·9
Total	...	29·5
Cash Certificates	... ...	6·6
Grand Total	...	36·1

The loan was distributed as under :—

		Mill. £
5 per cent. long term Loan of 1919—47	...	8·3
5½ per cent. 3-years War Bonds ...	...	13·2
5½ per cent. 5-years War Bonds ...	...	8·0
Total	...	29·5

The experiment of 1917 having proved encouraging, it was decided to repeat it in 1918 and it was arranged that the money raised by means of the war loans should be paid over to His Majesty's government as part redemption of the war contribution of £ 100 million made by India, of which a third had been already paid off. The loans had the welcome effect of placing at the disposal of the Government of India sufficient funds to make disbursements for His Majesty's government. In 1918–19 the receipts from the main section of the loan amounted to Rs. 51½ crores, government having offered 7 and 10 years Bonds at 5½ per cent. free of income tax, in addition to 3 and 5 years War Bonds. The receipts from the Post Office section exceeded 5½ crores. The offer of a 5 per cent. income-tax-free loan without limit of amount and repayable in 1945-55, gave the government in 1919-20, 21½ crores of rupees, of which Rs. 61¼ lakhs were received through the Post Office. The special propaganda associated with the previous two war loans was not repeated this time and therefore the public response was particularly encouraging. The rupee loan raised in 1922, yielded to government Rs. 45 crores, a significant result in view of the fact that no special effort was made to popularise it. During the post-

war years, annual loans have been on a large scale and have been used partly to pay off the war bonds which were accepted as subscription to the new loans. Money conditions being easy, the rate of interest was successively lowered from 6 to $4\frac{1}{2}$ per cent. and was bound to go down further. Prices of government securities also steadily rose. But during the last two or three years this position has shown occasional deterioration, attributed to political unrest in India, high money-rates abroad, unfavourable foreign exchange and our large capital commitments.[1] The market price of the $3\frac{1}{2}$ per cent. loan, for instance, which had risen from 58 to 77 rupees between 1923 and 1927, declined to Rs. 76, Rs. 72 and 64 in the three successive years. Similar decline took place in other securities, rupee and sterling.

The Government of India used to raise temporary loans long ago by issuing treasury bills; but their place was later taken up by the special reserves which were drawn upon in cases of need. But the drain on the Indian government's resources caused by heavy war payments for His Majesty's government and the Secretary of State's Council bills, led it in the middle of October, 1917, to introduce a new experiment viz. the issue of short term Treasury Bills which could be taken at option for periods of 6, 9, or 12 months. Three months' bills also were issued later on and by the end of the year 1917-18, about £ 30 million was obtained in this way. The Treasury bills issued to the public have recently reached large totals, and though this species of floating liability of government is not a very desirable feature of public finance, it indicates the direction of recent developments in this country. The revised estimate for 1929-30 showed an increase in the amount of bills from 4 to 24 crores, including 9 crores of increased treasury balance. The reader is already familiar with the nature and the amount of treasury bills issued to the Currency Reserve.

361. Post-War Position :—During the war-period and the post-war era of deficits, the unproductive public debt of India

1 Read Sir George Schuster's budget speech, 1930, for an explanation of the whole debt situation. It is significant that a 6 per cent. sterling loan in the form of 1933-35 bonds at issue price of £ 99 per cent. had to be floated in London on 19th May, 1930, though such borrowing was not regarded as necessary at the time of the budget.

expanded by leaps and bounds. Deficits have latterly ceased and additions have been made only to the productive debt. The responsibility of the central and provincial governments with respect to debt is now clearly distinguished as funds are borrowed on their respective accounts. The later position in regard to the national debt is reflected in the following statements :—

I

Total debt of the Government of India and distribution thereof.

(In lakhs of rupees.)

	31st March 1914	31st March 1918	31st March 1922	31st March 1925	31st March 1927
Funded debt in India :—					
Rupee Loans.	1,45,69	2,01,83	3,05,15	3,70,38	3,74,50
Treasury Bills in the hands of the public.	...	43,57	53,97	...	...
Treasury Bills in the Paper Currency Reserve.	...	...	57,87	49,65	41,47
Total funded debt in India.	1,45,69	2,45,40	4,16,99	4,20,03	4,15,97
In England, at Rs. 15 and at 1s. 6d. rate for last year:-					
Sterling Loans.	2,65,60	2,59,35	2,77,37	3,95,33	3,53,44
Unpaid balance of India's War contribution.	...	96,09	30,30	28,20	23,75
Capital value of liabilities undergoing redemption through terminable annuities.	1,05,90	1,05,90	93,37	88,05	74,91
Total Funded debt in England.	2,65,60	3,55,44	3,07,67	4,23,53	4,52,10
Unfunded debt in England.	...	...	...	34	34

I—Total debt of the Government of India.—(Continued).

(In lakhs of rupees).

	31st March 1914	31st March 1918	31st March 1922	31st March 1925	31st March 1927
Unfunded debt in India :—					
Post office Savings Banks.	23,17	16,54	22,26	25,65	29,49
Post office cash certificates.	...	8,88	4,04	13,12	26,68
Balance of Provident and allied funds.	10,93	19,08	32,99	42,55	60,74
Total unfunded debt.	34,10	44,55	59,89	81,32	1,07,4
Total debt ...	5,51,29	7,45,62	8,78,00	10,13,13	9,75,52

II—Distribution (in lakhs of rupees.)

	31st March 1914	31st March 1922	31st March 1922	31st March 1925	31st March 1927
Productive Debt :— Railways.	4,38,64	4,58,74	5,19,99	5,94,15	6,35,89
Telegraph. ...	11,31	312,25	15,24	18,20	13,25
Irrigation. ...	2,77	3,40	3,51	3,43	3,43
Vizagaptam Harbour.	...	...	...	...	95
Total Productive Debt.	4,27,72	4,74,07	5,38,64	6,15,07	6,53,52
Unproductive Debt of Central Government.	26,58	1,94,07	2,61,47	2,90,59	2,02,59
Incurred on behalf of Provincial Governments.	71,99	77,05	77,88	1,06,67	1,19,41
Total ...	5,51,29	7,48,62	8,76,00	10,13,13	9,75,52

362. Reduction of Debt :—In comparing the figures given in the above tables it should be borne in mind that the rate of con-

verting into rupees now adopted e.g. for 1927 is 18d. whereas for the previous years, it was 16d. The recent position will be clear from the figures in the last column of the tables. While our Finance Ministers used surpluses to reduce the unproductive debt, small though it was, the late Mr. Gokhale contended, year after year, that they should have been mainly devoted to the financing of schemes of social reform. Persistent surpluses, he urged, were funds taken out of the pockets of the taxpayers and must either be returned to them through remission of taxation or, much better, be devoted to the spread of education, improvement of sanitation and so on. During war-time and up to 1924, there were no surpluses but deficits which added to our small unproductive debt; and it was likewise increased by India's war contribution of Rs. 150 crores. The budget was balanced in 1924 but the surpluses that ensued after this, had to be devoted chiefly to the reduction of provincial contributions. Before the war, our surpluses were regularly used to reduce the unproductive debt small as it was. The following long extract from one of Mr. Gokhale's speeches in the Viceroys' Council, gives a lucid exposition of the per-war Public Debt position in India and of his views in that connection:—

"Sir, what is the amount of our debt? Our total debt is made up of various component factors. There is the permanent or funded debt. There is the temporary or unfunded debt. And there are various funds with the Government, such as saving banks deposits, service funds, special loans, judicial deposits in courts and so forth. Against this the Government have their Railways and Irrigation works, their loans and advances to local bodies, Native States and cultivators, and their cash balances. Deducting these latter from the total debt, what remains is the true ordinary or unproductive debt. Now taking the figures for 1907–08 and bringing them up to date, we find that in 1907–08 the permanent debt in India was 88·55 millions; the permanent debt in England was 156·58 millions, or, in the two countries together 245 millions. That was the funded, permanent debt, that year. The unfunded debt in that year was only 1 million. Then about 20 millions represented special loans, service funds, saving banks deposits, departmental and judicial deposits and miscellaneous obligations of the Government, or total liabilities of 266·28 millions or 400 crores of the liabilities of Government. As against this the Government of India had in that year 177·7 millions invested in Railways and 29·8 in Irrigation works or a total of 207·57 millions under the two heads together. The Railway debt was earning about 5 per cent., the Irrigation debt about 7 per cent. Therefore, it was really no debt at all in the sense in which the term debt is

used. That accounted for 207 out of 266 millions. The loans and advances by Government to various Local Bodies, Native States and cultivators amounted in that year to 13 millions, and the cash balances were 18·6 millions. Thus 239 millions out of 267·28 millions represented the investment and cash balances of the Government, leaving only about 27 millions of real unproductive debt for the country. This was in 1907–8. Since then the position has undergone some deterioration. Of course, there has been additional borrowing for Railways and Irrigation, but we need not take that into account since Railways and Irrigation investments are earning 5 and 7 per cent. interest respectively. But there was a deficit in 1908–09 of 3·74 millions. In 1909–10 there was a surplus of 6·1 millions and this year excluding the opium surplus of 3 millions, there is still a surplus of ·49 or ½ million. The position therefore during the last 3 years has undergone a deterioration by about 2·64 millions and we must add that to the figure for 1907–08 to find the total unproductive debt at the present moment. This comes to 29·7 millions. Or if the Finance Minister will prefer it, I am prepared to take the funded unproductive debt, as it appears in our accounts, which is 37 millions. That means making a present of about 7 millions to the Hon'ble Member but I will take 37 millions for the purposes of my argument. Now, Sir, what is a total unproductive debt of 37 millions for a vast country like India? What is such a debt compared with the huge debts of other countries? And is the reduction of this trifling debt a matter of such paramount importance that everything the Finance Department can lay hands on should be devoted to this reduction to the practical exclusion of all other useful objects, as has been done, during the last 10 or 12 years? Sir, my protest against this policy of the Government has been a long-standing one. Year after year, for the last 10 years, I have been raising my voice in the Council against this policy, but so far without much effect. How does our unproductive debt compare with that of other countries? In England at the present moment, you have a national debt of over 700 millions, corresponding to our unproductive debt. In France it is over a thousand millions. In several other countries it is four to five hundred millions. Even in an Eastern country like China it is 100 millions, though the annual revenue is much smaller than ours. The Hon'ble Member speaks of the necessity of strengthening our credit. If we look at the rates of interest at which different countries borrow, it will be found that our credit is exceedingly good."[1]

It was plausibly contended on the other side that a surplus could not be put to a better use than to the reduction of unproductive debt and that a similar practice and also a sinking fund arrangement existed in Great Britain for extinguishing public debt. What really

1 See Gokhale and Economic Reforms, pages 219–222.

happened in India during the first decade of this century was that surpluses persisted in occurring year after year, averaging about Rs. 4 crores a year. This was due partly to underestimation of revenue and overestimation of expenditure and partly to the existing high level of taxation—an effect of the new currency policy inaugurated in 1899. The surplus revenue ought, therefore, to have been spent on measures of social reform rather than in reducing the public debt. It has been pointed out above that India's unproductive debt increased by the addition of £ 100 million, on account of India's war contribution to Great Britain and annual deficits which harrassed the national exchequer for years after the close of the war. Sinking fund arrangements had been made in connection with a part of the old debt. It must be remembered that against these liabilities government had enough assests and it was only the war and post-war debts that were a dead weight burden. The enormous borrowings of the past few years have changed the whole aspect and the problem of maintaining India's credit abroad and of securing loans on reasonable terms, has caused some anxiety. While the political and the economic conditions were most unfavourable, government had to borrow heavily in 1929 and in 1930 to meet outstanding liabilities and to provide funds for the purchase of Railways. The rupee loan of 1929 yielded Rs. $35\frac{1}{2}$ crores, of which $22\frac{1}{4}$ crores represented conversion of bonds maturing from 1930 to 1932. In 1930, a rupee loan of Rs. $23\frac{1}{2}$ crores was required, of which only Rs. $7\frac{1}{4}$ crores would be new money.

It will be seen that some provision has always been made by government for the reduction and avoidance of debt; but it was felt that the heavy post-war liabilities of the State required "a regular programme based on stable and well-considered principles not subject to haphazard changes", in that respect. Depreciation funds had been already started in connection with the 5 per cent. loans; and the Finance Member discussed the whole question of debt redemption in his speech introducing the Financial Statement for 1924-25. "In December, 1924, Government announced a comprehensive scheme for next five years, which provided that there should be charged against the revenues of India each year for the purpose of making provision for the reduction or avoidance of debt, (*a*) a sum of 4 crores and (*b*) such additional sum as is equal to one-eightieth of any excess shown in the total of the

debt outstanding on the 31st March of the preceding year over the total outstanding on the 31st March, 1923. The totals taken for this purpose exclude Treasury bills in the Paper Currency Reserve, discount on loans for which separate provision is made annually and advances to Provincial Governments other than those representing pre-Reform Irrigation Debt."[1] In accordance with this scheme, the amount of revenue devoted to the reduction of debt was Rs. 4·7 crores in 1925–26, 4·8 crores in 1926–27 and Rs. 4.9 crores in 1927–28. The amounts for the next three years were Rs. 5·42, 5·73 and 6·00 crores (budget). These sums are carried to a redemption fund or if conditions are favourable are used in purchasing securities. There have now been instituted, as pointed out in a previous section, Depreciation and Reserve Funds in connection with the Railways, and the closing balances of these are estimated to be 17·2 crores and 17·90 crores respectively at the end of 1930–31.

363. Borrowing and Redemption:—In his very first budget speech, Sir George Schuster felt called upon to explain Government's policy regarding the public debt of India and provision for its redemption. Public opinion always disapproved foreign borrowing, as it meant an unnecessary drain of national resources and his predecessor also had advocated the policy that government finance should be based as far as possible on attracting rupee capital in India. The Finance Member accepted this principle, but pleaded that sterling borrowing may be indispensable in certain circumstances, particularly at a time when money was not forthcoming in this country and that there was nothing essentially wrong in taking loans from abroad when that is absolutely necessary and can be done without disadvantage. He further stated that sterling loans had not been unduly large and that they were more than covered by productive assets. In order to give the public a more accurate idea of the debt position, he modified the form in which his predecessor used to compile and present the relevant statistics. The modified statement was intended to show how the unproductivo debt was being steadily reduced and how the bulk of the public obligations were amply covered by substantial assets. We give the new tabulated statement of government obligations below:—

1 Report of the Controller of the Currency for 1924-25.

Statement Showing the interest-bearing obligations of the Government of India, outstanding at the close of each financial year.

	31st March 1923	31st March 1924	31st March 1925	31st March 1926	31st March 1927	31st March 1928	31st March 1929
			(In	Crores	of	rupees).	
In India:							
Loans (*a*)	339·83	358·81	370·37	368·28	374·44	372·25	390·61
Treasury Bills in the hands of the public.	21·59	2·12	...	...	...	7·59	6·15
Treasury Bills is the Paper Currency Reserve.	49·65	49·65	49·65	49·65	41·47	31·94	39·15
Other Obligations—Post Office Savings Banks.	23·20	24·79	25·64	27·23	29·51	32·67	34·74
Cash Certificates.	3·13	8·42	13·12	20·96	26·68	30·70	32·30
Provident Funds, etc.	36·17	39·00	42·39	46·36	51·02	55·82	60·42
Depreciation and Reserve Funds.	...	...	9·01	15·45	20·10	25·48	31·85
Provincial Balances (*b*).	2·86	4·17	4·83	11·87	10·49	10·48	8·09
Total Loans, etc.	411·07	410·58	420·03	417·94	415·91	411·78	436·71
Total other obligations.	65·36	76·38	95·06	121·87	137·80	155·15	167·40
Total in India.	476·43	586·96	515·09	539·11	553·71	566·93	604·11
			(In	millions	of £).		
In England: Loans (*a*).	222·92	244·53	(*c*) 263·09	(*d*) 266·35	265·09	272·32	282·04

(a) These figures represent the nominal amounts of loans outstanding and also include comparatively small amounts of expired loans which do not bear interest.

(b) These figures represent those portions of provincial balances which bear interest either because they form part of the old Famine Insurance Fund or the present Famine Relief Fund or because they have been placed with the Government of India on fixed deposit.

(c) Includes the liability assumed by the Secretary of State for East Indian Railway Debenture stock, aggregating £ 81¼ millions, on the termination of the contract with that Railway on the 1st January 1925. It, therefore, does not represent any increase in the foreign indebtedness of the country as a whole.

(d) Includes 27·07 crores on account of the liability referred to in (c) above.

	31st March 1923	31st March 1924	31st March 1925	31st March 1296	31st March 1927	31st March 1928	31st March 1929
War contribution	19·71	19·27	18·81	18·32	17·81	17·28	16·72
Capitial value of liabilities undergoing redempation by way of terminable railway annuities.	61·31	60·10	58·84	57·53	56·19	54·79	53·35
Provident Funds, etc.	·04	·13	·16	·21	·27	·19	·42
Total in England.	303·98	320·03	348·20	342·41	339·36	344·58	352·54
		(In	Croses	of	rupees).		
Equivalent at 1s.6d. to the Rupee.	405·31	432·04	454·93	456·55	452·48	459·44	470·05
Total interest bearing obligations.	881·74	9·9·00	970·02	996·36	1,006·19	1,026·37	1,074·16
Productive assets held against the above obligations.							
Capital advanced (i) Railways.	517·22	537·02	(e) 578·05	(f) 605·61	635·46	668·60	698·60
(ii) Other Commercial departments	19·43	20·07	22·00	17·77	19·16	20·60	21·75
(iii) Provinces.	87·49	97·56	106·43	114·60	120·17	126·34	136·95
(iv) Indian State and other interest bearing loans.	8·90	8·93	10·16	11·84	12·11	13·91	15·48
Total Productive Assets.	633·04	663·58	716·64	749·82	786.90	829·45	872·73
Cash, bullion and securities held an Treasury account,	44·80	50·47	57·35	51·96	37·48	24·26	3·570
Balance of total obligations not covered by above assets.	203·90	204·95	196·03	194·58	181·81	172·66	170·86

(e) Includes the liability assumed by the Secretary of State for the G. I. P. Ry Debenture Stock aggregating £ 3 ½ millions, on the termination of the contract with the Railway on the 1st July 1925. *vide* also last sentence under (c) above.

(f) Includes 4·88 crores on account of the liability referred to in (e) above.

The Finance Member felt that proper provision was not being made for the payment out of revenue, of interest, accruing on Postal cash certificates, and that liability in that behalf had been accumulating. He, therefore, thought that each year provision should be made for a sum equivalent to a fair rate of interest on the money government had at its disposal as proceeds of the sale of the certificates and that arranagements should be made to provide for the "accrued liability which is made up of the amount by which the sum paid in the past by way of bonus have fallen short of the interest which was really accruing during that period". It was, however, proposed that this obligation should be considered together with the general obligation of government to make provision for the writing off of their total debt. The considaration of this question and that of the scheme for the reduction or avoidance of debt had to be hung up in view of the general revision of the central government's finances and their relations to the finances of the Provincial governments which was expected as a result of the recommendations in connection with the forthcoming constitutional developments. There was also another question involved here viz. that of the adequacy of the Railway contribution to the general revenues of government. Sir George argued that according to the accepted convention, government receive, in addition to the refund of the actual interest which they have themselves to pay on loans raised for Railway purposes, a contribution which "may be regarded as a percentage on the capital advanced to the Railways" and represents the distribution of even less than 1¼ per cent. on to the government debt which forms the basis of the present provision for the reduction or avoidance of debt. In fact, the one balanced the other, and government get no profit from the Railways but 'apply practically all that they receive, apart from the refund of their own interest payments, for the amortisation of their capital" 'The result of this is that when the Railway contribution falls below a certain figure, the government, if they made up their accounts on a profit and loss basis, would actually show a net loss on the year. This throws very valuable light upon the nation's debt system and on Railway finance, and shows how the whole position is unsatisfatory. The Finance Member proposed that the two conventions viz. about debt redemption and the Railway contribution should be reviewed together.

364. Federal Finance:—In whatever manner the financial and the constitutional relations between the central and the provincial governments in India may have developed, it is undisputed that the national finance of this country can only be federal in character. Autonomous provinces and a strong central authority entrusted with functions calculated to enable it to maintain the unified existence of the whole nation, provide the only basis for a beneficent constitution for India; and the Indian States have to be assigned their proper place in the organization so that their economic interests may be properly looked after. In the national financial adjustments of the near future, the States will have to be given their due share in the taxes of all-India application. (1) The federal principle being once admitted to be the basis of financial relations as pointed out above, the next question refers (2) to the distribution of resources as between the central and the provincial governments. Here the examples of foreign federal constitutions will prove a useful suggestive guide, but none of them can and need be faithfully copied. We can not write on a clean slate in this matter, and the financial evolution of the past few generations can not be ignored. (3) The national functions of the federal, central government are clear and adequate resources have to be provided for their efficient discharge. (4) The resources to be allowed to the provinces must be of an elastic and growing nature as they have to be utilized for progressive social and economic development. (5) It is an erroneous idea which underlies the existing financial arrangements viz, that the resources of the central and provincial governments must be absolutely cut off from one another. Too much anxiety to free the provinces from the control and interference of the Government of India has led to this clean cut; and responsible government in the provinces with an unresponsible administration in the central government, has likewise tended to stimulate provincial at the cost of national patriotism.

(6) It appears to be a reasonable proposal that the income tax, with the exception of the super tax, should be made a provincial resource, as it is only fair that each province should be able to draw revenue from the non-agricultural as well as agricultural incomes of its people directly. (7) The other proposal that excise should go to the central government must be considered along with the above suggestion, and it is possible to work out satisfactory schemes on this basis. The special conditions of each province will, however,

have to be considered separately, and justice will have to be done to all. (8) No one guiding principle such as the size of population, present income and expenditure of the government, the taxable capacity of the people, the peculiar position of a province in the federation, geographical, political or economic, can be adopted for the allotment of provincial revenues—all of these will have to be taken into account and given proper weight. (9) Similarly, contributions, grants and subventions must not be ruled out altogether, and they will be a serviceable device for adjusting, balancing and rounding off resources. (10) Perfect equality as between provinces with respect to their revenues and expenses is not to be thought of. A fair treatment is all that can be and ought to be attempted. (11) After this is done, each province should be left to carve out its own future with the resources it has and can develop. (12) Death duties and inheritance taxes, when they will come, will have to be considered on the above principles.[1]

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1 For a good discussion of this subject, read the Report of the Taxation Enquiry Committee, Pramathanath Banerjea's "Provincial Finance in India" and K. T. Shah's "Federal Finance in India."

CHAPTER XX.

PRICES AND CONSUMPTION.

365. Consumption and Prices:—Consumption of wealth is the sole ultimate urge to its production. But this subject was long neglected by economists under the impression that it does not involve any scientific principles or laws.[1] It has now been realised, however, that methods of consumption have an important bearing on individual and social economic activities and on communal well-being; and the subject has consequently begun to figure among topics discussed in economic text-books. Consumption is not the physical or technical acts of using wealth and thus deriving from them the satisfaction of wants. It refers to the employment of income so as to secure from it the maximum of satisfaction with the minimum of expenditure. In a preceding chapter[2] we have indicated the intimate relation subsisting in India between changing methods of consumption and industrial and trade development and also the importance and possibilities of saving. We shall deal with the problem in some detail here. But before attacking it directly, it will be convenient to deal with the question of prices. After all, the standard of living and family budgets are powerfully affected by the use that can be made of incomes, particularly money incomes. The relation between real and money wages has been already shown in our chapter on workmen and wages. The purchasing power of money and the prices of necessaries of life thus constitute an important factor in economic life and welfare. It is often stated, for instance, that incomes were extremely low in India in pre-British times and that the range of consumption was very narrow. But this view will be wrong and misleading unless prices and the quantity and the quality of objects of consumption in those days are properly taken into account.[3] These

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1 See Charles Gide: *Cours d'Economie Politique* and Philippovich: *Grundriss der Politischen Oekonomie.*

2 See pages 245–246.

3 H. L. Chablani: *The Economic Condition of India during the Sixteenth Century.* And, Brij Narain: *Indian Economic Life.*

considerations are sufficient to show the importance of the study of the subjects discussed in this chapter.

When we estimate the comparative utility of an object there emerges .the idea of its value. The value of one object may be expressed in terms of other objects when the comparative estimates of their desirableness are stated. Not only are there several theories in Economics in connection with the causes of value with which we are not here concerned but there are thinkers like Cassel[1] who would eschew all discussion of value altogether as superfluous and restrict themselevs to prices. What is to be noted is that when value is expressed in terms of money, it is called price, and as barter has disappeared in all civilized countries, the question of prices has assumed considerable importance. What is the nature of prices and to what extent they are governed by cost of production and by the relation of demand for and supply of goods, need not be here considered. But it is necessary to understand that money is itself a commodity and as values are expressed in terms of money, its own value is an important economic factor.

The rise or fall of the prices of different commodities may be due to different causes. When the supply of a commodity exceeds the demand for it, sellers have to be content with a smaller price the purchaser may be willing to give. The reverse will happen if the demand exceeds the supply. What will be the degree of the rise or fall, will be determined by the keenness of the demand and the ability of the supply to wait for a turn of the market. Much depends upon the conditions under which the supply is produced, the time required to increase it, the substitutes with which the consumer is likely to be satisfied, and so forth.[2] An article may be imported from abroad or produced locally and the extent of the market for it, will determine its price. Prices of steel, sugar, food grains and silver will thus fluctuate according to different conditions.

Price is, therefore, an illustration of the law of demand and supply. There can not be a general rise or fall of values, but this phenomenon can take place in the case of prices. Value is a relation and involves a comparison between the desirableness of objects

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1 *Sozialokonomic.*

2 Marshall : *Principles.*

from the individual and the social view point. Money is a common measure of value like the foot or seer; but while the measuring capacity of these is fixed, if owing to a change in demand for or supply of money, its value changes, the alteration must be reflected in a general alteration in the prices of all commodities. Prices of different commodities are indeed always rising or falling in different degrees; and the changes may be accounted for on the ground of deficiency or excess of supply or of demand. If, however, the foot measure, for instance, were to be changed, the dimension of all objects will change. And a more or less uniform rise or fall of prices can not be explained by reference to a cause that affects a particular object; and we must look for an explanation of the phenomenon in change of the supply of the common measure of value viz. money.

366. **Quantity Theory of Money**:—A rise of prices means depreciation of money. When prices go up, the purchasing power of money goes down. In fact, the rise of prices and depreciation of money are two aspects of the same phenomenon. The fact that prices go down, means that a smaller quantity of money is sufficient to buy a stated commodity, and there is appreciation of money. With increasing supply of the instruments of exchange, their marginal utility declines; and it increases with deficiency of supply. The general law of value thus applies here also. It is on this relation between prices and the quantity of money in circulation that the "quantity theory of money" is based. The quantity of money includes paper as well as metallic money and other means of payment, because credit very largely expands that quantity; and the velocity with which money moves from hand to hand in exchange transactions, practically adds to the quantity. If the increase in quantity is accompanied by corresponding increase in the volume of goods exchanged, the price relation will remain unaltered. Taken with its limitations, the quantity theory of money is perfectly sound and satisfactorily explains the general rise of or fall in prices. If the number of coins or the media of exchange (including bank deposits which are subject to withdrawal by means of cheques,) in circulation increases to a larger extent than the commodities for which they are too be exchanged, there will be too much money and prices will rise. There will be a fall of prices if the quantity of money decreases or the quantity of goods to be exchanged increases while the circulation of money remains unchanged.

We shall not here deal further with the elementary considerations relating to factors which govern the fluctuation of prices in general and with the nature of customary and monopoly prices. The question of prices in India, as elsewhere, is mainly a question of the operation of the law of demand and supply; and evidence for this is to be found in the rise of the level of prices of food grains and the comparative cheapness of articles of luxury like refined sugar, in times of famine and scarcity. The defective character of communications and the absence of keen competition as also the predominance of custom in the economic relations of people, long governed the course of Indian prices and continue to so govern them in backward and isolated parts of the country. But the railways and public roads which have brought the various parts of the country into closer contact with one another and India itself into intimate touch with foreign countries, have changed the nature of the problem of prices which are more susceptible than before to changes in the markets of the world.

The history of prices in this country reveals the dominating influence which the character of the monsoon exercises upon their constant rise and fall. Though the improvement of the means of communication has tended to bring about an equalisation of prices in different parts of the country and a general rise in them, the prices of food grains, of raw materials and of indigenous manufactures are still regulated by the favourable or unfavourable nature of rainfall, the prices of imported goods being but slightly affected from year to year. Varying local prices are fast being replaced by uniform general prices, and the country is becoming one common market instead of a series of small local markets as in the past. Retail prices are also being regulated by wholesale prices much more strictly than before. And it is important to note that price levels appear to have been affected by the currency policy of government and therefore by the quantity of money in circulation. Regulation of internal prices through the exchange ratio was, in fact, the avowed aim of government in India[1] in 1920 and 1925 when public inquiries were made into the condition of Indian currency and exchange.

367. Course of Prices :—As we have just remarked, the favourable or unfavourable character of rainfall, its deficiency and

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1 See pages 603–606 and 624–632 above.

excess, is generally the regulator of prices in India and particularly those of the food of the people. The prices of articles of export, the bulk of which are the products of the soil, are likewise similarly governed, though demand for them in foreign countries is an important factor. The famine prices of 1877–78 and of 1899–1900 and the fabulous cotton price during the American War of Secession (1861–65) are instances in point. Prices of the years of the war period were the combined effect of several causes, shortage of shipping, congestion on railways, deficiency of production and supply and augmented circulation of money. The state of the world markets normally governs the prices of Indian staples which have a demand abroad and the general price level in the country is adjusted to prices ruling outside.

The general level of Indian prices began to rise in 1904, and went higher and higher every year, until the rise assumed almost alarming proportions. Prices were, on the whole, very steady under the silver standard, and the effective introduction of the gold standard inaugurated a rise. The index number went up from 100 in a normal year before the rise commenced, to 140 and even to 200 and more in certain cases. The rise was attributed to different causes by different people; and while it was welcomed by some as an indication of growing prosperity, others trace it to the pressure of population on land and the normal deficiency of food supply as also to the currency policy of government, which had, since 1899, artificially enhanced the gold value of the rupee. The question was discussed in the press and in the Viceregal Council, and the appointment of a commission of inquiry was suggested. Government thought that the new currency system inaugurated in 1893 and completed in 1899, had not had a sufficiently long trial and that commissions had always an unsettling effect upon things; they, therefore, deputed Mr. K. L. Datta to collect statistics on the question of high prices and asked him to submit to them a report thereon.

We give below index numbers of prices of a few selected articles, showing fluctuations and the steady appreciation,

Index numbers of prices are given for the period of war to facilitate comparison :—

I.

Year.	Wheat.			Rice.		Bajree.	
	Delhi.	Calcutta	Ahmed-abad.	Calcutta	Madras.	Delhi.	Ahmeda-bad,
1873	100	100	100	100	100	100	100
1891	135	98	122	91	145	151	122
1895	110	93	107	100	138	122	134
1900	168	113	149	110	180	145	201
1905	147	198	121	142	197	145	146
1909	203	142	155	156	218	157	166
1913	183	102	175	187	218	168	175
1915	239	...	187	197	203	229	208
1917	219	...	180	175	216	171	147

II.

(Average of 1900-09 = 100).

Articles.		1900	1905	1910	1913	1916	1918	1919
Wheat	...	106	84	109	107	128	149	211
Rangoon Rice	...	94	75	97	124	101	88	131
Raw Cotton (Broach).	...	55	93	94	134	127	283	276
Cotton piece goods (Indian Average.)	...	94	100	118	115	88	141	176
Tea	...	94	91	127	128	158	131	124
Country Rice	...	83	86	99	117	127	101	178
Ghee	...	88	96	124	142	134	162	204
Country Salt	...	95	96	108	108	188	496	330
Imported cotton piece goods (average).	...	91	96	114	119	126	295	322
Java Sugar	...	...	118	107	101	175	158	232
Kerosene oil	...	109	90	108	118	124	189	220

III.

Year.	Special Index No. for Food Grains (Retail Prices). Col. 1	Special Index No. for Imported Articles (Wholesale Prices). Col. 2	Special Index No. for articles Exported (mostly wholesale). Col. 3	General Index No. for articles covered by columns 2 & 3 Col. 4
1910	100	100	100	100
1911	96	104	107	106
1912	112	107	114	112
1913	118	107	121	117
1914	132	105	126	120
1915	130	134	122	125
1916	120	217	128	151
1917	120	240	134	161
1918	161	265	157	184

IV.

Index Numbers of Wholesale Prices in Calcutta.

Articles.		July 1914	March 1918	March 1919	March 1920	March 1921
Rice	...	100	83	128	147	127
Wheat	...	100	117	169	152	152
Dal	...	100	127	172	186	122
Sugar	...	100	181	222	321	369
Salt	...	100	486	237	310	216
Cotton (Manufactures.)	...	100	311	300	331	501
General average	...	100	176	180	198	175

V.

Wholesale Prices.

(Rs. per Maund of 82·286 lbs.)

		1913	1918	1919	1920
Rice (Calcutta)	...	5·7	4·9	7·2	8·4
Wheat (Punjab)	...	3·4	5·1	6·2	5·4
Jawar (Bombay)	...	4·1	6·6	8·1	5·6
Bajri (")	...	3·4	7·3	8·3	6·2
Gram (")	...	3·3	5·2	7·6	7·1
Ghee (Bengal)	...	54·8	68·3	78·2	94·9
" (Madras)	...	50·3	58·7	76·7	84·4
Sugar (Raw)	...	6·5	7·0	11·0	19·1
" (Refined)	...	10·7	15·1	21·6	30·5

368. High Prices in India :—The causes of the high prices which had prevailed during the first decade of this century, Mr. Datta concluded, were mainly of two kinds :—(1) causes peculiar to India, and (2) causes whose effects were world-wide.

Among the former were (i) a decreased production of food stuffs, (ii) an increased demand for Indian raw materials and food products, (iii) development of communications, and (iv) decrease in the cost of transport ; and among the latter, the chief were (i) an increased supply of gold, (ii) development of credit, (iii) destruction of wealth in wars and (iv) expenditure on armaments. Mr. Datta thought that all these causes combined to raise the prices in India and that the rise was not due to any one cause. He was, however, convinced that the prices of food stuffs in this country had risen on account of the fact that the food supply of India, compared with the demand, reached its lowest level in the quinquennium 1905–09 and thus shortage of supply undoubtedly contributed, in no small measure, to the unusual rise in prices during that quinquennium.

Broadly speaking, three theories about the rise of prices, held the field ; (1) that the large volume of the rupee currency which, under the gold exchange standard system, ceased to be automatic, led to the depreciation of the token rupee ; (2) that Indian currency had nothing to do with high prices which could be explained by economic changes of considerable magnitude going on in India and the outside world ; (3) the pressure of population and deterioration of the soil were mainly responsible for the rise of prices. Finance Members like Mr. Baker and Sir. G. Fleetwood Wilson, held the second view, and it was endorsed by Mr. K. L. Datta. Mr. Gokahle and others were inclined to accept the first theory and some emphasised the third. These views found expression in the Viceregal Council, when the question was referred to year after year.[1]

That the quantity theory of money applied to the problem, seems, however, to have been admitted by every one; and the difference lay in the emphasis laid upon the different terms in the price equation $M \times V = T \times P$, (M=money, V=veloctity of circulation, T = trade or volume of exchange transactions and P = price) and on the part played by the quantity of the token rupees in circulation. Thus Mr. Datta thought that the quantity of money increasing with the expansion of credit and increase in its velocity, prices of food stuffs were bound to rise while the volume of their production remained steady. If the supply of the

1 See Gokhale and Economic Reforms, pages 183–187.

food of the people had increased in proportion to the population and currency, prices might have remained steady. The Government of India did not, of course, admit the explanation of Mr. Dutta[1] about the insufficient supply of food grains. His theory was only an application of the law of demand and supply and must hold good if proper attention is paid to 'other things remaining the same.'

369. Currency and Prices :—Making full allowance for the fact that "India by its adoption of a gold standard, has been switched on to the currency gauge of the rest of the world and is undoubtedly bearing its share in the price fluctuations to which the rest of the world has been subject,[2]" and for the increased demand for certain of India's products which has overtaken the supply, as also for the pressure of population on the food supply, which does not appreciably increase, one is led to believe that the general rise of the price level was, to a considerable extent, due to the disproportionately large supply of currency. The spell of high prices ruling in Europe and America had been attributed to the increased output of gold and the consequent expansion of currency and credit all the world over. The same phenomenon was to be markedly witnessed in this country and the relation between high prices and the Indian currency system seemed to be intimate.

The official view was that the Indian currency system was automatic, that no more rupees were issued from the mints than were absolutely necessary for the purposes of trade and that it was the rise of prices which had necessitated the increased coinage of rupees. Government certainly issued rupees in response to the demand of trade, but the output of these token coins had been exceptionally heavy. And was there provision in the Indian system of currency for the timely contraction of the circulation of token rupees, the country's full legal tender money? Even a writer like Mr. Keynes, who is a supporter of a gold exchange standard, says :—"The effects of heavy coinage are cumulative. The Indian authorities do not seem to have understood this. They were, to all appearances, influenced by the crude inductive argument that because there was a heavy demand in 1905-06, it was likely that there would be an equally heavy demand in 1906-07 ; and when there was an actually heavy

1 Refer to our Chapter on Population and Food in Volume I.
2 Sir Guy Fleetwood Wilson in the Viceregal Council.

demand in 1906-07, that this made it yet more likely that there would be a heavy demand in 1907-08. They framed their policy, that is to say, as though a community consumed currency with the same steady appetite with which some communities consume beer."[1]

There was, during the years 1902-1907, a close parallelism between the growing output of rupees and the steadily rising prices. The rupees were not now melted in normal times, as they used to be before the closing of the mints, as this procedure entailed a loss. When the price of silver rose, it was at times profitable during the latter part of the war period, to melt rupees and use them as bullion ; and it is believed that in spite of government prohibition, large quantities of these coins were melted in this way. The absorption of currency among the people had been on a steadily increasing scale in pre-war years, and this inflation must have had a material effect in pushing up the price level. Experience has taught that rupees distributed over the interior of the country in payment for the staple products, do not quickly return to centres of commerce and industry, and efforts have sometimes to be made to get this currency back. If additions continue to be made to the existing stock of rupees, the inflation must raise prices though not in the some proportion, because a part of the currency is required to meet the increasing volume of trade. This is the way in which the unautomatic character of the currency system acts upon prices.[2]

370. Inflation of Currency:—Currency is indeed issued in response to a demand for the financing of the export trade in cotton, wheat, jute, oil seeds etc. Much of this currency returns to government treasuries and banks, but a portion remains in the hands of the people and in circulation. These continuous additions to the currency can not but result in inflation, the only counteracting force being the steady growth of trade. The experience of the year 1916-17 as to the extremely slow movement of rupees from circulation into the government treasuries, and the determined deflation that has been effected during the past four years, indicates that heavy absorption of currency, year after year, must have had something to do with the rise of prices along with other factors in the complex

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1 "Indian Currenoy and Finance."

2 Ref-rence may be usefully made to the discussion of this subject in the first three Chapters of this volume.

problem. Similar absorption took place in the case of currency notes also, and rupee currency has become redundant. When the prices of silver soared to abnormal heights during the latter part of the war-period, government continued to issue new rupees to the public in response to insatiable demand. In doing so, it was, as it were, pouring the coins into a sieve through which they escaped into the melting pot, in spite of prohibition, and into hoards. Owing to economic depression, quantities of rupees have returned to government treasuries and the metal holding of the Currency Reserve has become enormous.

The question of inflation has formed the subject of discussion in all countries during and after the period of war. The high prices ruling at this time, were admittedly the result of a deficiency of supplies of commodities chiefly on account of the divertion of productive activities to munitions, of the shortage of tonnage and of war destruction. In India, the rise in the prices of articles of import was much greater than that in the prices of articles of local production. The relation between the prevalent high prices and the heavy absorption of currency has been denied by officials. How the two are precisely related it is extremely difficult to determine, though it is obvious that the two phenomena are interdependent. But that prices have been pushed up at least partly by the large supplies of currency seems to be certain. Crores of rupees were spent by government for war purposes, and the coins and notes they put into circulation, were slow to return to the State treasuries. Hence the necessity felt of attracting the metallic currency, by means of war-loans, back to the treasuries and the banks. In a time of economic depression and during the dull season, the total note circulation of government in the week ended the 15th August, 1922, was valued at the record figure of Rs. 181·6 crores, Bombay holding as much as Rs. 61 crores and Calcutta Rs. 55 crores out of this total. Silver coin in the Reserve amounted, on the above date, to Rs. 81·7 crores. Securities held in India were valued at Rs. 65·2 crores and in England at Rs. 5·8 crores. The large circulation of notes, a considerable part of which were backed by government's I. O. U. s, must be regarded as an index of inflation, and in his budget speech, the Finance Member promised to effect deflation of currency in the course of the year. On 31st March, 1925, the gross circulation of notes amounted to Rs. 184 crores and the metallic portion of the

Reserve to Rs. 99 crores. The corresponding figures for 5th October, 1925 were 190½ and 112 crores; and for 22nd September, 1927, they were Rs. 181½ crores and 145½ crores respectively. On 15th May, 1930, the total note circulation was Rs. 173.40 crores and the value of coin and bullion was 142.38 crores, 106 crores being silver coin. A steady return of rupees from circulation has thus continued in later years and deflation has had to be persisted in.[1]

The problem of prices is complex and various factors exert their influence in determining the price levels. Insufficient supply of Indian products, high gold prices ruling in outside markets, the rates of sterling exchange, a large external and internal damand for Indian products, the expansion of credit—all these factors must be given their due weight. But the peculiar character of the rupee currency and the manner in which it is issued and is absorbed, can not be ignored as an important cause of the rise of prices. The relation between prices and exchange and the Indian government's policy in respect to it, have been already discussed at length in a preceding chapter. A rise or fall thus brought about, by the manipulation of exchange and currency, can not be camplacently regarded as natural and beneficial, and an effort must be made to minimise the influence of that cause by improving the existing currency system. The idea of prosperity induced by high prices must prove misleading if all the factors causing the rise are not taken into account. In recent years, however, low prices, economic depression and deflation have provided the nightmare in all countries, including India. A sudden deflation is undoubtedly dangerous[2] and the mercantile community has taken exception to the Finance Member's scheme of deflation as it was calculated to bring about monetary stringency and to lead to a crisis. But deflation, gradually and judiciously brought about, is an absolute necessity under given conditions. The intimate relation between monetary circulation, prices and exchange was prominently brought out in the discussion of the 18d. ratio recommended by the Hilton Young Commission and adopted by government. A high exchange, low prices and

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1 "Actually, since the beginning of the last busy season, say, from the 1st December 1928 to the 30th November 1929, the net contraction was 15·89 crores and the net reduction of notes in circulation was only 2·48 crores."—The Finance Member's budget statement, 1930.

2 See Gustav Cassel's "World's Monetary Problems."

deflation were here bound up together; and in fact, rigid and effective currency control and the systematic regulation of monetary circulation were the burden of the song with the Commission.

371. Effect of Varying Prices :—Owing to their disturbing effect upon industry, trade and the family budgets, particularly of people with fixed incomes, fluctuations in prices are always deprecated and stability of the purchasing power of money is sought and welcomed.[1] Different interests are in apparent conflict here. Rising and high prices mean "good times" to producers while wage-earning and salaried classes want cheapness. Steady prices with a tendency to a small and slow rise is preferred by some on the ground that this stimulates economic activity and rewards the enterprising and the industrious.[2] It is mainly the difficulty of adjusting incomes and costs to changing prices that causes hardship. At one time high prices were a cause of anxiety; recently rapidly falling prices have afflicted industry all the world over. Disparity between prices on the one hand and wages and profits on the other, causes economic friction and losses and engenders discontent and distress. And the problem has to be considered from the point of view of the community as a whole as well as from those of the interest of the agricultural, working and capitalist classes. In our chapter on Production and Population we have shown how, if more mouths have to be fed with the same or a slightly increased quantity of food, prices must rise; and this rise can not be an object of congratulation or consolation in view of the fact already noted that the closing of the other industrial avenues is driving many people on to the land. It is superfluous to repeat that the producers of raw materials which command higher prices in the foreign markets, will benefit to the extent of the larger margin afforded (i) if the profits are not intercepted by middlemen and (ii) the cost of production is not increased. And raw materials required for indigenous industries must be sufficiently cheap as also the necessaries of life of the mass of the population. Then only will high prices prove beneficial to producing classes. This does not mean that low prices as such are desirable either, because these reduce employment, profits and the purchasing power of the large mass of the people.

1 Refer to the work of "The Stable Money Association" of New York, U. S. A.

2 Gide : *Principles of Economics.*

Cultivators supplying their own labour and producing their own food, receive larger real incomes on account of high prices. But those who have to employ dear labour and buy dear food and other necessaries of life, can not be any the better for a higher level of prices. We have shown that food production in India has not kept pace with the increase of population. A rise in the price of food grains, therefore, which is brought about by insufficiency of supply can have no beneficial effect upon the community. Even if we take only the producers of food grains, though rising prices must be an advantage to them, it must not be forgotten that to the growing number of agriculturists this must be only a palliative. Cheap food is regarded everywhere as an essential thing to a nation, and we must have an abundance of cheap food rather than insufficient supplies of dear food grains. Cultivating classes will, however, suffer if their produce becomes cheap without corresponding reduction in their costs. And this is what has recently hsppened in India.

The country, as a whole, must benefit by a rise in the prices of exported commodities only if there has been no corresponding increase in the prices of imported goods.[1] The true benefit will be measured by the difference between the prices of the exported and imported commodities, their character and their quantity. During recent years, as the price statistics given in the tables on a preceding page will show, the prices of imported articles rose higher than the prices of exported commodities. Though the high prices of exportable goods have thus benefited the producing classes the advantage gained by them and by the country as a whole, has been counteracted by the higher range of the prices of articles imported into the country which ultimately affect all classes of the community. Further, a fall in prices of agricultural produce, resulting from a higher rate of exchange, is bound to hit the cultivating and other producing classes hard. We must here recall the fact that the local food production of the country is not adequate

1 Mr. Dutta observes:—"India's exports have thus grown considerably in value in consequence of the rise of prices and only a part of this increase goes towards meeting the increased cost of her imports. There has also been a considerable increase in the volume of the imports of many classes of goods required for consumption and the increase in the imports of many classes of goods which were formerly considered as luxuries but are now recognized as necessaries, bear eloquent testimony to a standard of living which is rising higher and higher with the rise of prices and the material prosperity of the country."—Report on high prices.

to the demand of a reasonable standard of living; and classes with a higher degree of purchasing power will naturally absorb a large quantity of such food as is available, and the middle and lower classes will find necessaries of life dear and scarce. Recent additions to taxation have tended to reduce the consuming capacity of the people as the taxes have been shifted on to consumers; and cloth, salt, oil, sugar, ghee, housing, lighting, fuel are all dear. Lowering and steadying internal prices has been the fixed aim of government's currency and exchange policy in India, and gold and rupee prices were thus brought into a new relation through the rise of exchange to 18d. The following table shows the recent movements in price levels :—

Wholesale Prices in Bombay.[1]

July, 1914 = 100.

Twelve-monthly Average.	Food	Non-food	All articles
1918	171	262	236
1919	202	233	222
1920	206	219	216
1921	193	201	199
1922	186	187	187
1923	179	182	181
1924	173	188	182
1925	155	167	163
1926	145	152	149
1927	143	145	147
1928	144	146	146
1929	150	143	145

372. Speculation and Prices :—Prices in the interior of the country are generally regulated by custom and are little affected by the fluctuating movements of trade in the big towns. It is only in the case of the staple articles of export such as cotton, Jute, oil seeds &c. that conditions prevalent in foreign countries affect prices in the districts. Retail prices are not easily disturbed by the fitful currents of wholesale dealings in the larger markets, though the connection between the two, is becoming closer every day and is particularly

1 Published by the "Labour Gazette," Bombay.

marked in the larger towns. Improvement of communications is responsible for this change with which the cultivating classes are becoming more and more familiar. Concentration and specialization in production make buying and selling upon a large scale necessary. Even a small merchant has to buy in anticipation of the demand he will have to meet and he makes his own calculations as to the quantity and price. There is some risk involved in the purchases of large quantities long before they can be disposed of. But that is the chief function which the merchant performs and for which the consumer remunerates him. Buying in anticipation of demand prevents sudden and large changes in the price levels and bespeaks business foresight and skill. Wholesale merchants in port towns and other cities have, however, unfortunately fallen victims to the speculation mania, and there is no commodity in which they will not gamble. Gold, silver, sugar, cotton, shares, all provide them material to indulge in the craze and the fluctuation in prices which results, is seriously injurious to the interests of the mass of consumers.

A cotton manufacturer must ensure an adequate supply of the raw material at a reasonable price. Cotton is produced in a certain season and its quantity and prices are likely to be affected by several circumstances e. g. the condition of the cotton crop in the U. S. A. He must, therefore, buy in anticipation and must thus indulge in a kind of speculation. "The essence of speculation lies in forecasting price movements and then buying or selling for a profit. Having made his forecast, the speculator buys if he thinks prices are going to rise, sells if he thinks prices are going to fall. He looks to the future and works on an estimate ; he takes the risk of loss if his forecast is wrong in return for the chance of gain if his forecast is right."[1] Manufacturers and merchants, therefore, buy and sell on contract and certain people specialise in effecting these speculative dealings. Sales and purchases for future delivery are carried on by brokers ; and cotton, jute and other exchanges have come into existence in this country. In Bombay and Calcutta, the markets for these staples are controlled by associations of dealers who have their special rules under which speculative transactions are carried on. Speculation, if it is resorted to with the definite object of securing and supplying commodities at fixed prices, is

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1 Henry Clay : Economics.

socially very useful and has the effect of steadying prices. But there is a bad kind of speculation like the good kind, which degenerates into pure gambling.

A person both buys and sells 'futures' to make his gains and losses even ; and there is nothing wrong in this. But many people buy and sell without having the least idea of ever taking or giving delivery when the day fixed for 'settlement' comes. The payment of difference in the rates fixed involves loss to one of the two parties, because the calculations on which the prices were based may be upset by circumstances beyond his control. Reckless and irresponsible speculators use all kinds of arts to manipulate prices in their own interests and the whole market is thrown into commotion and confusion by the manoeuvers of 'bulls' and 'bears'. The ruin of a few people may lead to a widespread disaster and the whole structure of credit may be rudely shaken. The condition of the Bombay cotton market in March and April of 1918 with respect to speculation in Good Broach, whose price was pushed up by 'bull' operators to unprecedented heights, was an interesting illustration in this connection, which has been repeated in a milder form since then.

There has latterly been a good deal of discussion relating to the cotton and the stock exchanges in Bombay. The condition of the cotton market became so dangerous to financial stability on account of the reckless cornering and gambling in 'futures' indulged in by speculators that at last government had to intervene and to provide, by legislation, for a well-regulated controlling authority in the form of a cotton control board having on it representatives of the different interests and associations concerned in the trade, a permanent body being later created by law to undertake the duties of the board. The Cotton Contracts Committee of 1918 which was a war measure, was replaced by the Cotton Contracts Board next year which continued to function till 1922 when the present East India Cotton Association was created by legislation. The need is felt of regulating, in a similar manner, the working of the stock exchanges, of which there are now two in Bombay, the old and the new Exchange, the new body having been brought into existence to supplement the facilities afforded by the old exchange. The speculative mania has often reached such heights that a serious shock to public credit has been very narrowly escaped. Various improvements have been talked about, *e. g.* regulation of the 'settlements' which are

monthly under the existing system. The bulls and the bears have been very active in Bombay and their recriminations do not present an edifying spectacle to the outside public. The action of the Board of Directors of the Bombay Stock Exchange in fixing the rates for certain shares for particular settlements, and their lack of strength have been freely criticised. The frequent wranglings of the bulls and the bears, it has been urged, must be ended by a strong and impartial board of directors whose policy must be consistent and in consonance with fixed rules. The Government of Bombay appointed the Atlay Committee to investigate the working of the stock exchange and in 1925 proposed certain drastic rules. The Exchange, however, resisted outside interference and promised internal reform. There being no prospect of these promises being given effect to, the Government of Bombay proposed legislation to regulate the working of the Exchange.

373. Standard of Living :—With the expansion of currency and the more general use of money, the habits and tastes of people of all classes are changing. In England wages rose to a high pitch owing to the war and as more money circulated in the country, the working classes spent more and devoted their earnings to the consumption of luxuries which were formerly beyond their reach. The working classes in England, women as well as men, have become accustomed to a higher standard of life and their wages have had to be fixed in accordance with it. That phenomenon is observable, on a small scale, in this country also. Improvement of communications and imports of cheap articles of every day use from foreign countries into India, combined with rising prices and higher wages, have induced people to consume such articles, and this consumption is producing interesting social effects. Restrictions imposed by caste, religion and custom, are becoming slack and new ways are being adopted in eating, dressing, drinking, furnishing houses, in amusements and in other matters.

The growing imports of certain articles of luxury and convenience are taken as an indication of the above change in the objects and methods of consumption and as an unmistakable indication of material prosperity of the bulk of the population. An increasing use of clothing and of clothes of a better quality, the construction of better houses, the consumption of wholesome food in sufficient

quantity, improved water supply and sanitation, the provision of medical aid, a growing literacy and habit of reading and a more liberal access to the sources of innocent amusement and of the general amenities of life,—these will certainly bespeak a higher standard of living. Still the mere substitution of one article for another or a mere change of social customs, is, by no means, a sure sign of true prosperity.

The middle and the lower classes of population are doubtless now able to command certain comforts and luxuries which formerly they could not dream of enjoying e.g. cheap drinks, cinema shows and motor bus rides; and to that extent there are signs of the standard of living rising higher. Prevailing depression and unemployment are, however, factors which offset this improvement. More money indeed circulates among the rural population than before; but most of the rayats have no stocks of grain, as they used to have, there is scarcity and deterioration of milch cattle, and the people do not seem to feel better off in spite of the changes noted above. Whatever prosperity we see, is mostly the prosperity of the few; and the volume of wealth appears to flow from the countryside to centres of industry and trade and from the mass of the population to the middlemen. The rude plenty of the past is fast becoming a matter of history, to be cherished as a tradition.

There is no doubt about the fact that economic changes which are in operation in the country to-day, are producing far-reaching effects upon the methods of consumption and the general social status of several classes. Many people who have adjusted themselves to the new forms of industrial organization, are now able to earn more than if they had remained in the old grooves prescribed by custom. They continue to be members of the old castes but their standard of living is being raised to that of the higher castes. They live, speak and dress differently, and social equality is being created by economic improvement. From the point of view of consumption, Indian society no longer wears the old static aspect, and changes are visible on every side. Most of the articles of luxury and convenience such as gramophones, cinemas, harmoniums, soaps, china ware, fountain pens, are, however, largely for the use of the urban population, and the masses dwelling in villages have but a small share in that prosperity.

374. Consumption and Prosperity:—The increased consumption of imported articles may be an indication of material progress, so far as it goes. But there is the other side. Mr. Ramsay Macdonald says of the use of articles of luxury by the working classes in India as follows:—"Better clothes are being worn, cigarettes are beginning to take the place of the hookah, alcohol is being more widely consumed, shoes are more general, umbrellas are becoming more common. The people's wants—too many of them debased—are becoming more costly to meet. As evidences of increased prosperity, I place little reliance upon such facts. These things no more show prosperity than expensive weddings or extravagant funerals."[1] An increase in the number of wants is indeed desirable and a larger supply of necessaries and comforts is indispensable for material progress. We see physical and intellectual lethargy in the villages, and anything that will shake people out of it, is welcome; but the masses are still uninfluenced for good by modern civilization. And the articles consumed either as substitutes or additions, must not lead to physical deterioration and moral debasement; and changes in the manner of living, clothing, amusement and so forth, must be conducive to healthy physical and moral development. Tea-drinking has already spread into the interior of the country and among all classes of people. In the Bombay Presidency "the rapid multiplication of places of refreshment where tea is sold is remarkable and the beverage is becoming popular with the masses." Workmen, employees and others, find in tea a welcome beverage which braces the nerves and gives temporary energy. It can be easily prepared and can be had without difficulty and at times when it is required. Coffee takes the place of tea in the south, while northern India is addicted to neither. Tea seems, however, to be steadily advancing into the north and making a lodgment in its exterior fortifications.

The loss and deterioration of milch cattle in the country, present a problem of the most serious import to the health and strength of the community. There has been an unprecedented scarcity and dearness of milk and ghee, and prices even in normal years are higher than those of famine times in the past. The problem of the preservation and improvement of cattle is of the greatest economic

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1 **The Awakening of India: pages 177–78.**

importance. Dearness of milk must produce physical deterioration and infant mortality, and the question of fodder supplies which is connected with it, must be taken in hand immediately. The substitution of tea for the more wholesome bread and milk as food, can not, however, be recommended and the prevalence of the tea habit is to be deprecated on this ground. The place of an adequate quantity of cheap, wholesome food of the old kind, can not be taken by drinks and foods of the modern fashion without detriment to the health of consumers. And many are martyrs to tea and coffee and, therefore, to dyspepsia and other diseases. The habit of consuming liquor is, again, on the increase and unfortunately it is shown as a sign of material prosperity. Among the lower classes, particularly in towns, drinking prevails to a large extent. The introduction of money economy is placing cash in the hands of workmen who are tempted to spend a large portion of their earnings on liquors and other intoxicants. The war, which brought temporary prosperity to the certain classes, encouraged drinking to an appreciable extent. And the time seems to have arrived for the State to control and check the comsumption of intoxicants.

The two chief religions of India, Hinduism and Islam, have condemned drink and yet the lower classes are taking more and more to it. Several workmen drink away a large part of their wages and make themselves and their families miserable. In the Punjab, for instance, we are told that "among all classes the increased means have not been accompanied by a proportionate development of the rational enjoyment of leisure. The Jat, if his religion does not forbid him, spends more time with the bottle and too many find in the excitement of the law courts their relaxation." This is an illustration of the spread of the evil of drink throughout the whole country; and the efforts of temperance reformers have clearly not produced any appreciable effect.

In the third chapter of this book, an attempt has been made to give an idea of the Indian out-look on life and on the material world. There and also in later chapters, we have referred to the contact of modern Western civilization with the culture and social organization of India. The economic, social and political evolution which began 150 years ago, is rapidly proceeding and the pace of the progress has been recently quickened. There is a steady approximation to European ideals in dress, manners and institutions, and the goal of

progress is believed to lie in the clothing of the Indian spirit in the garb of modern civilization. Dramatic performances, cinemas, liquor shops, gambling on the race course, cigarette-smoking and vices of all kinds absorb a large portion of the earnings of labourers and other classes in towns; and extravagance of the worst sort is seen to eat as a canker into the vitals of the rich and also the lower middle and lower classes. The mass of the population in India has not yet experienced the full effects of the impact of the two civilizations, though the reaction of the new forces on the people in the economic, political and social spheres is clearly visible. Changes in production and distribution have been described in the earlier chapters; and those in consumption are noticed in the present chapter.

375. The Masses and Consumption:—Indian cultivators and handicraftsmen have struck observers as people of simple habits, sober, contented and God-fearing. But their thriftlessness and extravagance in marriage ceremonies and funerals as also their fondness for ornament have attracted a good deal of attention; and these are often exaggerated.[1] Extravagance is a relative term.[2] Disproportionately large expenditure on certain items of comparatively less importance from the point of view of the more urgent and essential needs of health and culture, is imprudent and undesirable. The truth is that the mass of the people in India have all the weak and the strong points of a predominantly agricultural and industrially backward population. We have already stated that the cultivator and the artisan rarely distinguish between productive and un-

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1 Mr. Datta says in his Report on High Prices:—"The Indian cultivator is, as a rule, thriftless and extravagant and much addicted to litigation. He lacks that business education which leads the rayat to restrain his tendency to borrow and which enables him to calculate the results of expenditure whether on improvements or otherwise."

2 "The results of the commission's inquiries show that undue prominence has been given to the expenditure on marraige and other festivals as a cause of the rayat's indebtedness. The expenditure on such occasions may undoubtedly be called extravagant when compared with the rayat's means, but the occasions occur seldom, and probably in a course of years the total sum spent in this way by any rayat is not larger than a man in his position is justified in spending on social and domestic pleasure......The sums usually spent on these occasions have probably been over-estimated, or the operation of other causes in producing debt has been overlooked by the officers who have attributed the rayat's burdens so largely to this cause."—Report of the Deccan Riots Commission.

productive expenditure. Western civilization brings with it, again, its drawbacks as well as its conveniences and comforts. It is by a balance of these that progress is to be estimated here. If by extravagance is meant individual or family expenditure far in excess of the income, leading inevitably to indebtedness and dependence, there is extravagance of a sort in these matters among all classes of the community; and debts contracted for social and religious purposes are not regarded as something undesirable, while the debts entailed by economic conditions, are unavoidable. Custom requires that so much shall be spent on festive and mournful occasions, and to most people custom is an irresistible tyrant who takes a heavy toll of his victims. Dowries must be paid and castemen must be fed even at the risk of utter ruin. Nature thus plays her pranks and conspires with man to bring about his downfall. A strong faith in luck or Providence and fatalism reconcile people to their fate, and this explains the apparent contentment of the mass of the population with their poverty and misery.

But sweeping assertions about extravagant and ruinous expenditure must be deprecated. Such imprudence is only a manifestation of a common human failing. Social reformers have been crying against the evil for years in vain. And thriftless habits afflict the high and middle classes as much as the masses. But it is the last who suffer most. Factory labourers and artisans are no less free from indebtedness than cultivators, but there are a few thrifty people in all the strata of society and the saving habit has to be inculcated and strengthened. Several of the immigrants into cities live most frugally denying to themselves all luxuries. Wages earned and saved in towns are remitted to villages to support families on the land. It is an interesting phenomenon that people migrate from the districts to towns for earning a living as factory workers, peons, domestic servants, petty traders &c. and they remit home their savings with which the family hearth is kept burning and new landed property is purchased and old property is repaired. An analysis of the population of Bombay city reveals the interesting fact that about a fourth of it consists of immigrants from the Deccan districts. A very large section comes from Gujerat and Kathiawad and from Indian States on that side, and these people are known to remit considerable savings to their 'homes.' The temptations of town life, it is true, are too strong to be resisted and lead the otherwise simple workmen into paths of evil living. The social reform

movement has not yet touched the lower classes, and it is they among whom it must spread. We have already referred to the indebtedness and poverty of the rayats; and everything which will make their lives brighter, give them sufficient food, shelter and clothing and raise them physically, morally and intellectually, must be attempted by those who are interested in the uplift of the nation. To-day, they are drifting, not knowing whither. Motor transport has now become extremely cheap and is no longer a luxury even to village people who are easily tempted to take a ride in a lorry rather than drive in a bullock cart or walk or remain at home. Rural parts are changing but slowly, on the whole, however, so far as consumption of wealth is concerned. It should be borne in mind that changes in the standard of living which come with a growing contact with modern civilization, are inevitable in India, and that effort has to be made to give them a proper direction.

376. Post-War Prices:—The high prices which prevailed during the latter part of the war-period, were expected to continue in the post-war years and were the basis of the great economic speculation and activity which characterised the years immediately succeeding the declaration of peace. Owing to the exhaustion brought on by the war, to the disparity between the increased productive capacity and the lowered consuming power of the world and the absence of real understanding and peace among nations, industrial and commercial operations received a setback and prices of commodities steadily came down. The sudden fall was destructive to many new and weak economic enterprises and embarrassing to old and established concerns. A fierce struggle for existence ensued and prices declined. The level of wages which had been raised between 1918 and 1920, however, remained high and consumers who had been harrassed by soaring prices, began to breathe a little more easily. As the production and supply of the commodities are governed by different conditions, the fall in prices was not uniform. This will be seen from the fact that sugar, tea and cloth did not become as cheap as food grains, for example. During the period 1914–1925, prices were the highest in the middle year, viz. 1920 and in that year the fall commenced. Among the necessaries of life, food grains became the cheapest and cotton cloth the dearest, the general average prices being 50 per cent. higher than the pre-war level. The greatest increase had taken place in the price of sugar

and this article remained dear longar than any other commodity; but towards the close of 1925, sugar became comparatively cheaper than cotton cloth which continued its obstinate dearness. The consumption of cotton cloth was about 18 yards per head of the population in the pre-war years. It was reduced by nearly 40 per cent., the imports of British piece goods diminishing by one-half. Consumers have been reluctant buyers and stocks even of indigenous cloth have accumulated. The prices of milk, ghee and vegetable oil did not show any appreciable fall, but fortunately for consumers, cereals and pulses became sufficiently cheap, their prices depending more or less directly on the nature and extent of the rain-fall in the country. The following table shows comparative wholesale prices during the pre-war and post-war periods :—

Index Numbers of wholesale Prices in Calcutta By Groups of Articles.

(Prices in July, 1914=100)

Period	Food grains.		Sugar	Tea.	Textiles.		Hides and skins.	Metals.	All Commodities.
	Cereals.	Pulses.			Cotton-raw.	Cotton Manufac			
1914, End of July	100	100	100	100	100	100	1C0	100	100
1915, Annual Average	115	122	164	115	89	97	102	120	112
1916 " "	106	107	184	114	121	134	118	186	128
1917 " "	92	96	189	95	174	203	112	266	145
1918 " "	110	119	180	95	309	298	96	301	198
1919 " "	163	180	268	105	230	295	184	238	196
1920 " "	154	162	407	78	153	325	147	237	201
1921 " "	145	160	270	180	143	280	108	175	178
1922 " "	137	152	221	150	191	239	120	166	176
1923 " "	114	112	246	206	244	221	135	162	172
1924 " "	123	114	239	205	272	229	121	162	173
1925 January	135	115	206	196	212	222	127	137	165
1927 Jan.	143	155	184	140	127	156	117	138	146

Comparative index numbers of prices in Great Britain and India for a series of years, have been given in a preceding chapter[1]. Index numbers for wholesale prices for Calcutta and for Bombay which are officially published, differ from each other, the latter being generally slightly higher. Both have steadily fallen, however, since 1925. The Bombay index number for food prices declined from 148 in December, 1928 to 143 towards the close of 1929 and the general index number from 147 to 141 (on the basis of July, 1914=100). In March, 1930 the general index number was 137, the same as in February. It is natural that the working class cost of living index number should show a steady fall in sympathy with the general fall in the level of prices. This index number which was 155 in 1925 and in 1926, went down to 147 for 1928 and stood at that figure in January, 1930. In April, it was 141 as against 142 in March. The index number of food articles included in this index was 138, one point lower than in March, 1930.[2]

377. Rural Life:—The life of the Indian villager is of the simplest kind. Bread of Bajri and Jwari, or of Wheat in Northern India, and Rice in Eastern and Southern India, accompanied by a small quantity of vegetable, forms the common dietary. Meat is a normal part of the diet of Muslims in certain parts of the country and is occasionally eaten by some Hindu castes. Fish is more common in coastal parts and peculiarly so in Bengal districts. Clothing is rough and cheap in the case both of men and women, and according to Western ideas, insufficient. When a potential labourer first leaves his village home in the Konkan, he is almost in a state of nature except for the small loin cloth and catches the fashion of the dhoti and the shirt in the town where nude simplicity is not appreciated. Growing contact with urban people has been rapidly changing this phenomenon. A large number of villagers are not able to secure productive work and therefore to earn a living for several months of the year. They are, therefore, insufficiently fed and have to run into debt. Interest that has to be paid to the creditors makes a serious inroad into the small average earnings of the rural population. The houses in villages have mud walls and thatched roofs and they are kept clean,

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1 See pages 630-631.

2 See Bombay *Labour Gazette*.

though ideas of personal hygeine and general cleanliness, are at a discount among the lower classes. Tobacco chewing and smoking is very common and the weed is almost a necessary of life. A few trinkets and holiday clothes to be worn on special occasions, constitute rural luxuries. Most of the village people and many workers in towns, are sunk in chronic indebtedness and unless and until they earn more and learn thrift, it is hopeless to expect much improvement in their condition. The standard of living of people of the highest castes among Hindus and among towns people generally, is higher, and is characterized by simple prosperity. They are better housed, clothed and fed and have fine tastes.

The condition of the depressed classes is everywhere shamefully deplorable. These poeple have to live on the outskirts of villages and towns and they are really outcastes. Their houses and general surroundings are dirty and filthy. Manu and other Hindu law-givers and the Mahabharat have described the origin of the people of the untouchable classes, the dirty occupations they must follow and the wretched food they must eat. For two thousand years these classes have been living what is hardly a human life. Even to-day they are not allowed, in Southern India, to walk through the streets and their shadow is pollution to caste people. The uplift of these classes, which is associated with cleanliness, education and decent occupations, is now being taken up as an urgent national problem and strenuous and sustained efforts alone will solve it. The labouring population in towns is fast changing its habits and customs and this change is very slowly permeating the country side where kerosene, corrugated iron sheets, glass and Chinaware, cycles, cheap lampware, matches, cigarettes, soap, tea and toys are being introduced into common use. Villages in the vicinity of towns and along the railway lines are feeling the effects of this impact of the urban areas.

The contrast between cities and villages is more marked in India than in other countries. Villages predominate in India and the methods of consumption of the majority of the people are characteristically rural. Townspeople have fast become westernized in dress, manners, speech, amusements and so forth; and imitation and assimilation are proceeding apace. Of the Punjab peasant it is said that to-day he is not quite what he was ten fifteen ago, that the railway had already brought the modern world to his gate,

but that the war brought it to his sight.[1] A large proportion of the income of a rural family is spent on food and this proportion varies inversely as the means. The truth of Engel's law is thus here established. In Eastern Bengal the proportion of the total budget spent on food by families in comfort is 58 per cent. and by families in indigence 69 per cent.[2] The Indian cultivator or labourer can not be compared to the farmer or workman in the West in the matter of wages and the standard of living. They are so unlike each other. The average income of an American working man's family is calculated at Rs. 2,328, 42 per cent. of which is spent on food and a large percentage is used in buying comforts. The average income per family in the Deccan village of Dr. Mann's inquiry, is only Rs. 218 and it appears that 70 per cent. of this is spent on food and above 22 per cent. on clothing. He concludes:—"The people in the most sound position are those with small families, with few children, with much land and with few debts. Only 8½ per cent. families are able to maintain themselves on the land alone, 27 per cent. on land plus outside labour and the remainder appear to be unable at present to reach the standard of maintenance which they themselves set up."[3]

378. Variety in Consumptoin:—Generalizations about the methods and amounts of consumption in India, will not be true to facts. The extensive variety we have in climate, soil, race, religion, culture and earning capacities in the different parts of the country, has created different modes of dress, dwelling, food &c. which are simply bewildering. Contact with one another, brought about by improved means of communication, is indeed rapidly tending to assimilation, by provinces and districts, of the ways of life of their neighbours. This growing uniformity must, however, be limited by variety, fixed in the nature of things. The inhabitants of the Punjab are compelled by their cold climate to wear thick and woollen clothing and construct their houses so as to afford sufficient protection against it. The clothing of the people of the southern provinces is the scantiest and is made entirely of cotton. The food that the inhabitants of any part of the country eat, is mostly determined by the climate and the produce of its fields, and hence wheat, jawar, bajri

1 M. L. Darling.

2 J. C. Jack: The Economic Life of a Bengal District.

3 See also several village studies which have recently been published, e. g. Mukhtyar: "Life and Labour in a South Gujarat Village."

and rice have become staple foods in different provinces. These food-grains are comparatively cheap in the provinces where they are produced and cousumed in the bulk.

The population of port towns is cosmopolitan and has been materially influenced by western civilization. People who earn their living by pursuing modern methods of industry and trade and factory labour in industrial centres, are assimilating new ways of living, though most members of the mercantile classes are peculiarly conservative. Reference may be made to pages 830–833 in this volume in order to bring the objects and the methods of consumption of factory labour into relation with the money and real wages obtained by that class of workmen as also by agricultural labour. An analysis of the budgets of factory workers' families in Bombay gives the following percentage expenditure on the main groups of commodities in 1921–22 :—

Food ...	...	56·8 per cent.
Fuel and Lighting	...	7·4 „ „
Clothing ...	...	9·6 „ „
House-rent ...	...	7·7 „ „
Miscellaneous	...	18·5 „ „
		100·0

The shape and the style of houses are governed very largely by the climate and the building materials that are readily available. Hence the variety of stone, bricks, mud, timber, bamboos etc. used in the construction of dwellings. Heavy rainfall requires a particular kind of roofing, earthen tiles or stone work. Mud roofing is enough in districts where the rainfall is small in quantity e. g. Sholapur and Ahmednagar.[1] Proximity to forests makes cheap

1 "Clothing and the structure of the people's dwellings also vary in like manner, being partly determined by the requirements of the climate, partly by the nature of the materials available. In Afghanistan woollen fabrics and sheep skins are in general use, and the former are much worn also in the Punjab in the cold season by those who can afford them, while the poorer classes wear clothes padded with cotton wool. Cotton fabrics of varying texture are the ordinary clothing of all classes in India, and silks are very much worn in Assam and Burma; but the least civilized tribes of Chutia Nagpur, of the hills of Assam and Eastern Bengal, and the natives of the Andaman Islands, are able to exist with the smallest possible amount of clothing habitually worn by any of the human races."—Macmillan's Geography of India.

timber available and the abundance of certain kinds of thatching material fixes the style of roofs. Differences of race and religion also play their part, as much as the natural conditions, in fixing the nature of the consumption of people; and the factors of ignorance and intelligence must also not be ignored. In the costume worn and the food eaten, Hindus differ from the Mahomedans in central and south India, and centuries of common citizenship have not imparted uniformity to social customs. Thus are accounted for the varieties witnessed among the people of different castes and communities of the Punjab and Bengal, of Bombay and Madras, in respect of the kind of wealth they consume and their methods of consumption.[1] The internal variety in each province and locality is, of course, to be attributed to the economic condition of different places and classes with reference to their trade and industries. Dictates of religion and custom have had a powerful influence in regulating consumption; as also the degree of the security of life and property enjoyed.

The ease with which goods can be transported from one part of the country to another by means of the railways, is breaking down provincial and communal isolation and bringing about uniformity. Cloth, sugar, matches, cigarettes, hardware, soap, apparel, kerosene, paper, glass, umbrellas, motor cars. &c. which are imported from abroad, are evenly distributed by the railways all over the country for common consumption; and the imitation of western dress and furniture and a spirit of common Indian nationality, are producing the same results. Religious and caste prejudices are steadily giving way before the advance of western civilization in the country. European styles of housing, furniture and dress are being copied everywhere on an increasing scale. Shirts, boots, collars, hats, chairs, tables, steel trunks, harmoniums, gramophones, cups, and saucers,

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1 The curious may read with interest the account given in his Ayeen Akbary by Abul Fazal, of the food, houses, dresses &c., of the subjects of the Emperor in the different subhas. Speaking of Bengal, he says:—"The food of the inhabitants is for the most part fish and rice; wheat and barley not being esteemed wholesome here. Great numbers of men and women go quite naked, except covering for the loins. In this country women are allowed to transact business in public." Concerning Orissa, he writes:—"The periodical rains continue during eight months; and they have three months of winter, and only one month that is very hot. Rice is cultivated here in great abundance. The inhabitants live upon rice, fish and vegetables. After boiling the rice they steep it in cold water and eat it the second day."

spoons, glasses, bottles are familiar objects all over the country. The interior of the country has been made easily accessible by the cheap provision of motor conveyances of which the rural population is now taking advantage in a growing degrèe. Houses of the new rich, in particular, are European through and through, though the social manners have not been yet radically changed. This evolutionary process is permeating the lower strata of society; and the 'Khaddar' movement is apparently powerless to stem the tide. Khaddar has, however, rendered useful service by bringing out the incongruity between the poverty of the people and the western fashions to which they are becoming addicted.

373. Saving and Investment:—Frequent references have been made in previous chapters to the condition of credit in India, the indebtedness of the mass of the people, lack of banking facilities, the spread of the co-operative movement and investments in government loans. We shall not, therefore, go over that ground again. How far the banking habit is spreading in the country, it is difficult to gauge with any pretensions to accuracy. Our evidence in the matter consists of the deposists in the joint stock and Postal savings banks, the contributions of people to the loans floated by government and the progress of co-operative credit; and it points to a steady improvement in the desired direction so far as the people of the higher and middle classes are concerned. The numerous new industrial joint stock companies which have come into existence, leave no doubt about the popular tendency towards saving and investment, but the share of the common people in this movement is probably small. It is mostly the classes who were accustomed to saving and whose earnings left an appreciable margin to be invested, that have participated in the new investments.

It is no doubt a fact that though our cultivating and labouring classes are poor and have little margin and incentive for saving out of their incomes, there is room for thrift in their families. Their extravagance may be exaggerated, still expenditure on weddings, funeral rites and on interest on old debts contracted for these purposes, is capable of being cut down. The rate of interest on the loans is anything between 50 and 150 per cent.; and the influence of custom is so overwhelmingly powerful that families ruin themselves for maintaining their social prestige by spending beyond their

means. The ignorance of the mass of the people and the formalities that have to be gone through by the investors in purchasing securities and in collecting interest are a serious obstacle that hampers investment. Government is fully alive to this and has been simplifying the procedure connected with investments in its loans. But even then the educated and the intelligent classes alone can take advantage of the facilities. The cash certificates, for example, brought to the State a decent amount of money but the pressure of persuasion that was exerted under the stress of war conditions, did not produce desirable effects. Several people who bought the certificates, which really represented a very good investment, did not understand the nature of the transaction and thought it was a kind of a war contribution to government, and they are reported to have disposed of them even at a loss though they were readily encashable. The cash certificates have, however, now become a popular security with the educated classes. The activities of the Post Office savings banks must be extended and joint stock banks also must give facilities to customers to attract deposits. The importance of such facilities has come to be appreciated and investors are assisted to save and put money into government loans.

In his speech introducing the financial statement for 1919-20 the Finance Member explained what government had done and intended to do to attract the small investor and his little hoard to its loans. He pointed out that whereas in the 1917 loan, the number of investors excluding purchasers of cash cetrificates, was 1,55,103, in the loan of 1918, the number of subscribers was no less than 2,27,706 and observed that it was clearly of the highest importance that every effort should be made to retain and if possible to increase the new *clientele* and to foster the seed which had been sown. Among the advantages of the gradual spread throughout the country of a habit of investment, he pointed to the diversion to fruitful purposes of India's sterile hoard of the precious metals to the mutual benefit of the individual and the State. Finance Members have since then given expression to similar sentiments and the investigations of the Banking Inquiry Committees are calculated to prove particularly helpful in this direction. Habits of economical consumption have to be spread among the mass of the people, however, and the advantages of foresight and of providing for the future have to be impressed upon their minds.

380. Charity:—The various items of individual and family expenditure which are in perpetual competition with one another, may be grouped under the following five heads viz. necessaries, comforts, luxuries, investments and charity and their proportion to one another depends chiefly upon the size of the income and to a small extent on the spender's inclination. A few persons will invest in land and the precious metals at the cost of comforts and luxuries, and expenditure on charity is a religious and social duty with the bulk of the people. Much of the traditional and present day charity in India causes avoidable waste. The instinct of sympathy for the poor and the distressed and of veneration for learning and piety, which is guided and strengthened by Indian religions and customs, often leads to extravagant and wasteful methods of expenditure. Help which ought to be given to the truly deserving, is frittered away on sturdy beggars and habitual idlers. An Indian's conscience will not allow him to turn away a beggar from his door; and tramps and able-bodied professional mendicants take advantage of this attitude of mind. Paupers who can not work for a living, helpless widows and orphans, the blind and the cripples must all be supported by the community, and individual and collective charity has been doing this work. Individual and family responsibilty for charity of this description which has been well recognized in India, has obviated a State organization for the purpose. Endowments of temples and mosques, almshouses and caravansaries, of wells and cisterns are common. And within recent years, schools, hospitals and orphanages have been founded by pious people for the benefit of the public.

The Hindu joint family—a survival of the patriarchal form of the family—is a co-operative institution and maintains the young, the aged and the weak members. But that institution is rapidly falling to pieces before the growth and spread of individualism. The advantages and disadvantages of the joint family, we have referred to already. Very often it serves as an efficient instrument of production, but in distribution, it fails to give satisfaction and the family becomes a hive in which the workers and the drones quarrel. In consumption, the joint family is economical and is a great help to the aged and the weak and exhibits its usefulness in a most conspicuous manner. The serious drawback of the joint family lies in the jealousy, hatred and quarrels it encourages and a sense of irresponsibility it fosters. The peace and happiness of members are marred by individual dis-

content; and partitions of landed and house properties produce uneconomic results. "The gains of learning" bill which was recently before the Legislative Assembly, illustrates one of the serious difficulties and complications associated with the institution. It is not impossible to combine individualism with the family instinct; and relatives in difficulties and distress may be taken care of by members of a divided family who are in a position to do so.

That the organization of Indian religious and charitable endowments is not satisfactory, has now come to be widely recognized and the question of placing these on a sound footing has been discussed by our legislatures. It is admitted that religious and charitable trusts are being abused and badly managed and that they do not carry out the objects of the original donors. Some hesitate to allow State interference in such matters; but without strict outside control exercised on behalf of the whole community, existing abuses are not likely to be corrected. This is now a live political issue in the various Provinces, and a solution has been found for it in Madras by a legislative measure. Beggars in India have become a nuisance and the problem of dealing with them has attracted a good deal of public attention. Much can be done in this regard by individuals who must refuse to encourage indleness and vagrancy. True charity, enjoined by religion can not mean the support of beggars who will not work for an honest living. Communal and public organization must take the place of the individual charity which does not serve much useful purpose. Beggars, especially sturdy mendicants, become a public danger and have to be strongly discouraged. The beggar problem is acute in cities, e. g. Bombay, and a solution for it is being attempted. To be able to live without working to obtain a living, appears to certain persons and castes as a hereditary or individual privilege; and mendicancy and charity under the circumstances, have a detrimental effect upon production. The instinct for charity must be preserved and be given a socially useful turn. And fortunately, this change is slowly taking place.

381. Simplicity and Luxury:—As consumption is the principal aim and destination of all production, exchange and distribution of wealth, it is needless to add, its nature, size and methods are intimately related to the whole economic life of man, individual and social. No rapid economic progress, particularly along western lines,

it is stated, is possible in India because the people's outlook on life is so narrow, their wants are so few and their tastes are so simple and even primitive. If you are contented with a little quantity of rice and salt for food, a little clothing to cover your bodies and a rude cottage to protect you from the sun, the cold and the rain, where is the scope for industrial development? It is useless to expect India to make rapid economic progress, we are told, so long as the average standard of living is low as compared with that of western people. This question of the Indian attitude on the material world, we have dealt with in some detail already, and it is not necessary to do more than refer in passing to what has been said on the subject. Nevertheless, one or two things require mention in this place.

Firstly, it is a woeful mistake to judge the Indian people by the western standard and then to ridicule or pity them,[1] for instance, for the scanty clothing of the men and the children. A man clothed in western garb is not necessarily a more cultured and a happier man. External imitation of the people of the west is certainly not a merit and does not, as a matter of course, indicate progress and happiness. Standard of living is not some thing that is more or less permanently fixed though it must be intimately bound up with natural, cultural and economic conditions in any country at any given time. It rises or falls with prevailing economic conditions and ideas, and changes with times and circumstances. It likewise varies with different classes in the community, and among them also it is not absolutely unalterable. There is at any given time, in any given class or society, a tacit understanding that material goods of a certain quantity and quality are essential for satisfaction and comfort. Contentment is a condition of the mind, and without the use of certain objects, absolute necessaries and conventional necessaries, if not luxuries also, an individual will not feel happy. The primary physical wants are inexorable and must be satisfied at any cost; and it is the above social convention that is the principal force that drives ambition on to competition and enterprise. Man is by nature imitative, and effort to copy new methods of wealth consumption alters the standard of living. Secondly, therefore, it must be noted that the standard of living in India has changed from time to time.

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1 Refer to books like Miss Mayo's "Mother India" which betray a lack of understanding and perspective.

There is ample evidence in history to demonstrate the truth of this remark. The effect of Mahomedan conquest and of the contact with Muslim civilization, on Hindus, for example, was not small during the 16th and 17th centuries. The social history of the small Parsee community is significant in this connection. Indian modes of life have thus undergone continuous change, and the same phenomenon is visible at the present moment, under the influence of western civilization.

Thirdly, it is a pure delusion to suppose that the Indian people, as a whole, were, at any time in their history, a community of Sanyasis shunning, as a matter of principle, all material enjoyment, or a set of rural folk not knowing and caring for the luxuries of urban life. History clearly shows that Indian society always had its fashions and conventional modes of living which had to be conformed to. Fourthly, there is another delusion, which is the reverse of the above and must be similarly disposed of, and it is that the common mass of the people have fallen off from a higher standard of living during the last one hundred years. It is true that in the past, it was open to persons of capacity and ambition to rise to any social heights by their daring and enterprise and a peasant or a shepherd of to-day was a potential nabob or raja or a military commander of to-morrow. The material prosperity of the past was not and could not, however, be the prosperity of the lower strata of society. It was naturally confined to the higher, the warrior, trading and landholding classes who had opportunities to amass wealth, to command the services of others and procure luxuries and comforts. These had servants and retainers, slaves and serfs, like the European barons of old, and the lot of the masses could not have been happy according to our present standards. Land was, however, abundant and such food, clothing and shelter as the people required, were not difficult to obtain. There is doubtless deterioration in this regard in existing conditions, but there is the counterbalancing factor that opportunities are being opened to the lower classes to improve their condition and share in the general rise of the standard of living. The complaint in India to-day is that such opportunities are few and there is no incentive to a better living for the people taken as a whole.[1] The middle and the agricultural classes thus find themselves to-day

1 See Report of Royal Commission on Agriculture in India and the Author's *Economics in India*.

in a bad plight, and the position of the educated and semi-educated people is pitiable. The latter have placed new, and in many cases false, standards before them which they can not realize.

382. The Ideal and the Actual:—Fifthly, Indian ideas of what are necessaries and comforts, are also fast changing, and new standards are being established among all classes and ranks in the community. Indian poverty and prosperity are being judged and will, in a larger measure, be judged by these new standards. The proverbial simplicity of India is by no means opposed to the changing standard. An increase in the number and a change in the nature of wants, must not be regarded as incompatible with the spirit of renunciation and simplicity. The lives of some of the greatest of Indians and of certain classes in the community, are a proof of the truth of this statement. It is a marvel to outsiders how the 'Saint of Sabarmati' clad only in loin-cloth and living on hard, simple food, can attract lakhs of devoted followers from the wealthy and the worldly-minded classes. The Gandhi cap and the khadar shirt serve as a reminder of Indian poverty and of the need for retrenchment and economy in private expenditure. Our religious heads are seen to-day travelling in motor cars instead of in palanquins, and our social ceremonies, if not religious rites, are invaded by the products of modern civilization. Renunciation has ever been venerated and simplicity has been praised in India. But simplicity is relative, and no particular standard exists to judge it. Imitation of western manners and modes of life is, in fact, proving wasteful and embarrassing to persons who have been victims of the externals of European civilization, and the corrective influence of old Indian ideals is necessary in such cases. It will be worth while studying Mahatma Gandhi's movement in favour of Khadar and his campaign against liquor and litigation, from this point of view. The paraphernalia of western standards is found to tax the limited incomes of the middle classes. The idea that money goes out of the country to pay for these luxuries now tending to become necessaries, (*Swadeshi*), is lending to the manufacture of the required articles in the country itself, e. g. tooth powders and brushes, soaps and razors, collars and neckties, buttons and belts, underware and boots, lamps and sporting materials. Economical methods of production and consumption must not be discarded because they are foreign; but they must not be adopted when they are likely to become a handicap in

life. The position in India to-day is that the large mass of the population falls short of even the accepted traditional Indian standard in consumption of wealth, and is of course far away from the new standard.

Changes in the methods of wealth distribution are reacting upon the methods of consumption and on the standard of living. The substitution of contract for status and of modern systems of production and exchange for the customary organization, is bound to produce a radical effect upon consumption. The new opportunities for saving and investing are being availed of, and life insurance and provident funds are becoming common among the higher and the middle classes. But it is the lower classes that have not been able to catch up in the race, and works of public improvement have not yet reached them so as to ameliorate their condition. Their lot is wretched, and though they are untouched by the evils of western tastes and civilization, they have still to cover a long distance to share in the advantages of material progress.

Further, as has been pointed out above, the joint family system is an important economic factor, and an average Indian family is an association for consumption as well as for production. This institution, as well as the caste system, is based on the principle of solidarity, and it would be interesting to study both from the point of view of consumption. Partitions of real property are indeed common and usually render production inefficient. The joint family system, like the caste, has its advantages and drawbacks. It renders living economical and conduces to the protection of the weak and the aged. But it likewise chills enterprise and puts a premium on idleness. Bickerings among the members of a joint family are normal and their life is rendered unhappy. This institution is likewise a kind of insurance for the members against illness, incapacity and death. Caste and communal organizations for consumption and charity are note-worthy in India. But there is a growing tendency now-a-days among the educated classes to resort to life insurance and to help organized effort at poor relief, education, medical treatment &c. The total number of policies in force in India in 1928 were nearly 4¾ lakhs and the amount assured under ordinary life assurance policies, which has been steadily increasing, was Rs. 124 crores in that year. Of this total, Indian companies assured Rs. 71 crores under 3,22,000 policies.

Lastly, the instinct of charity is strong in India, and owing to the prevalence of private, individual charity, the need of the poor law does not exist. Orphanages, hospitals and other institutions for the relief of the weak, the helpless and the suffering, have indeed come into existence, and there is immense scope and extensive need for their increase and development. The problem of sturdy beggars and mendicants who consume without making any contribution, direct or indirect, to the production of communal wealth, is urgent in India. There is waste of consumption going on in this direction which must be cotrolled and reduced. Charity must be diverted to more useful channels conformably to the needs of national progress, e. g. education and medical relief. Attention is directed more and more to the improvement of charitable endowments and institutions of a religious nature.

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APPENDIX I

We give below a few statements of the latest available statistics relating to the position of prices, currency circulation, foreign trade and the Imperial Bank of India. It will be seen from them how the tendencies with respect to economic depression, currency deflation and falling prices, which have been discussed in this Volume, are still in operation :—

(A)

Comparative Prices

	Index Numbers. Wholesale Prices. April 1925.	End of 1928.	End of 1929.	Cost of Living. April 1925.	End of 1928.	End of 1929.
Great Britain	161.9	137.6	125.4	173.0	165.0	164.0
U. S. A.	144.6	140.9	125.0	158.0	157.0	157.0
Canada	162.0	147.7	150.2	152.0	151.0	154.0
Belgium	...	125.0	116.6	...	216.0	228.0
France	...	128.0	114.1	...	113.0	115.0
Germany	141.0	138.9	132.3	136.0	153.1	151.6
Italy	...	125.8	113.9	...	148.0	150.0
Japan	204.0	172.2	154.9	241.0	208.0	194.0
India (Bombay)	165.0	147.0	141.0	158.0	148.0	150.0

	Percentage Changes. Apl. 1925 to End of 1929. Wholesale Prices.	Cost of Living.	End of 1928 to End of 1929. Wholesale Prices.	Cost of Living.
Great Britain	—22.5 p. c.	— 5.2 p. c.	— 8.9 p. c.	—0.5 p. c.
U. S. A.	—13.5 "	— 0.6 "	—11.3 "	...
Canada	— 7.2 "	+ 1.3 "	+ 1.7 "	+2.0 p. c.
Belgium	...	...	— 6.7 "	+5.6 "
France	...	...	—10.9 "	+1.9 "
Germany	— 6.1 p. c.	+11.5 p. c.	— 4.7 "	—1.0 "
Italy	...	...	— 9.4 "	+1.4 "
Japan	—24.0 p. c.	—19.5 p. c.	—10.0 "	—6.7 "
India (Bombay)	—14.5 "	— 5.1 "	— 4.1 "	+1.3 "

(B)

Foreign Trade of British India.

1929–1930

(In lacs of rupees.) + Signifies net exports.
— „ „ imports.

	1st April 1929 to 31st March, 1930.	1st April 1928 to 31st March, 1929.
Imports of merchandise ...	2,40,76	2,53,31
Exports including re-exports of merchandise ...	3,17,93	3,37,96
Net imports of Gold ...	14,22	21,20
Net imports of Silver ...	11,89	13,04
Total visible balance of made ...	+ 52,82	+ 52,11
Net balance of remittances of funds. ...	−21,01	−41,39

(C)

Paper Currency Returns.

(In lacs of Rupees.)

	22nd May 1930. Rs.	22nd Apr. 1930. Rs.	22nd May 1929. Rs.	22nd Apr. 1929. Rs.
Notes in circulation ...	1,70,64.9	1,73,32.3	1,83,04.4	1,84,71.7
Reserve-Coin and bullion in India—				
Silver coin ...	1,07,05.4	1,06,64.4	94,28.4	94,77.2
Gold coin and bullion.	32,27,6	32,27.4	32,21.6	32,21,6
Silver bullion under coinage ...	3,37.3	33,8.3	4,33.5	4,67.0
In England—				
Gold coin and bullion.	...	...	...	...
Silver bullion ...	...	...	...	...
In His Majesty's Domn.—				
Gold coin and bullion	...	...	...	...
In transit between India, England and His Majesty's Dominions—				
Gold coin and bullion	...	...	...	...
Silver bullion ...	...	...	...	...
Total bullion and coin ...	1,42,70.3	1,42,30.1	1,30,83.5	1,31,65.8

	22nd May 1930. Rs.	22nd Apr. 1930. Rs.	22nd May 1929 Rs.	22nd Apr. 1929. Rs.
Securities (purchase price)—				
In India ...	27,50.2	30,72.4	43,22.8	43,22.8
In England ...	44.4	29.8	8,98.1	8,83:1
Total Securities ...	27,94.6	31,02.2	52,20.9	52,05.9
Grand Total of Reserve ...	1,70,64.9	1,73,31.3	1,83,04.4	1,83,71.7
Internal Bills of Exchange held on account of Government under Section 20 of the Indian Paper Currency Act, 1923 ...	...	...	...	1,00.0
Percentage of Metallic Reserve to notes in circulation ...	83.62	82.10	71.48	71.66

(D)

Imperial Bank of India.

(In lacs of Rupees.)

	23rd May 1930. Rs.	18th Apr. 1930. Rs.	24th May 1929. Rs.	19th Apr. 1929. Rs.
Liabilities :—				
Subscribed Capital ...	1,125.0	1,125.0	1,125.0	1,125.0
Capital paid up ...	562.5	562.5	562.5	562.5
Reserve ...	532.5	532.5	522.5	522.5
Public Deposits ...	1,661.9	1,529.4	657.0	680.3
Other Deposits ...	6,825.4	6,899.3	7,261.3	7,433.4
Loans against securities per contra ...	166.7	166.7	...	...
Loans from the Government of India under section 20 of the Paper Currency Act, against Inland Bills discounted and purchased per contra	...	...	...	200.0
Contingent liabilities	...	...	...	...
Sundries ...	164.0	140.8	150.3	102.3
Total ...	9,913.0	9,831.2	9,153.6	9,501.0

	23rd May 1930. Rs.	18th Apr. 1930. Rs.	24th May 1929. Rs.	19th Apr. 1929. Rs.
Assets:—				
Government securities ...	2,671.4	2,702.7	2,104.7	1,908.5
Other authorized securities under the Act ...	283.2	283.5	253.0	238.6
Ways & Means Advances to the Govt. of India	...	...	...	...
Loans ...	1,388.5	1,400.3	1,097.9	1.804.2
Cash Credits ...	3,230.6	3,244.5	2,945.1	2,890.0
Inland bills discounted and purchased	458.2	577.1	716.1	1,045.7
Foreign bills discounted and purchased	51.8	47.6	33.8	47.8
Bullion ...	...	...	...	...
Dead Stock ...	282.2	281.2	285.4	283.9
Liability of constituents for Contingent liabilities per contra	...	...	...	...
Sundries ...	80.3	60.8	68.6	50.9
Balance with other Banks	37.9	31.7	24.3	37.8
Cash ...	1,428.9	1,201.8	1,624.7	1,193.6
Total ...	9,913.3	9,831.2	9,153.6	9,501.3
Percentage ...	16.20	13.75	20.13	14.18
Bank Rate ...	6 p. c.	6 p. c.	6 p. c.	7 p. c.

APPENDIX II

STATUTORY COMMISSION AND FINANCE.

Federal and Provincial Finance

It will be interesting to notice that the chief points we urged in our discussion of the reform of the system of finance and taxation in the 18th and the 19th Chapters of this Volume, viz (1) that the system should be federal in character, (2) that the share of the Indian States in the burdens it imposed, should be duly recognized, (3) that a complete separation of the resources of the national and Provincial governments is not essential and (4) that the income tax should be a divided source of revenue, larger agricultural incomes being included in the amounts to be assessed, have been endorsed by Mr. W. T. Layton, the expert adviser of the Statutory Commission. The latter has, however, suggested that the Indian States claim, that they should receive a share in the customs revenue, will have to be set off by a similar counter–claim that they must bear a part of the increasing cost of Imperial burdens. The Butler Committee, therefore, proposed the appointment of an expert body to enquire into both claim and counter claim. Mr. Layton observes:—" But whatever the decision may be as regards the past, the development of India's finance in accordance with the plan outlined in this report will make the Central government increasingly dependent on customs revenue and increase the taxation which it imposes on the population of the states at a time when the cost of the Imperial burden is stationary or falling. It will, thus, strengthen the case for determining what is the burden that may in equity be imposed upon the states. Further, if uniform national excises are to play an increasing role in Indian finances, they will, if levied at the point of production, constitute a new form of taxation on the population of the states and make it still more important to find a means of harmonising the financial policy of the Indian states and of British India."

" This matter is, moreover, not merely one of financial adjustment, but gives rise to a claim that the representatives of the Indian states should be consulted on financial policy. The financial problem illustrates the need for the progressive development of the machinery of consultation between British India and the states, which the commission have proposed."

Mr. Layton's report is based on two general assumptions, firstly that it is both possible and desirable to improve the economic and social condition of India by a substantial increase in expenditure on the nation-building services, and secondly, that it is possible to raise additional revenues for this purpose provided that incidence of further taxation is adjusted to the capacity of the taxpayers to pay. If additional taxation is to be raised it is necessary that the new constitution should ensure

(a) that sources of revenue appropriate to their requirements are available for those authorities who have urgent and expanding services to administer.

(b) that all parts of India make a not unfair contribution to the common purpose.

(c) that the responsibility for imposing additional taxation is definitely laid upon those who will have to incur additional expenditure.

The existing financial scheme does not adequately fulfil those conditions especially as Provinces with rapidly expanding needs have sources of

revenue which are almost stationary. Provinces are treated unequally and industrial provinces have no power to tax industries. Analysing the elements that compose the Central Budget, Mr. Layton says that a surplus is likely to emerge gradually as a result of the growth of revenue, the chief contributor to which will be Customs. The surplus will not, however, be realised if the expansion of trade is checked by internal disorder or external difficulties or if India adopts a policy of extreme protection. Any prospective surplus in the Central Budget will go a comparatively little way towards meeting the needs of the Provinces. It is, therefore, essential to find new sources of revenue. Four sources are mentioned :—(1) increased yield of in-come-tax by lowering exemption limits, by steepening graduation in the case of intermediate incomes and by taxation of income invested abroad ; (2) abolition of exemption of agricultural incomes from income-tax ; (3) national excises on such commodities as cigarettes and matches; and lastly, (4) Terminal taxes. Item (4) is a form of taxation which falls naturally within the provincial sphere ; but the others are taxes which should be the subject of central legislation and should be centrally collected.

"Three methods of dealing with this situation have been suggested :—

(a) the assignment of all revenues (including customs &c.) to the provinces where they are collected and the financing of the central government by means of appropriate contributions from each province ;

(b) the transfer to the centre of certain services now performed by the provincial governments, or while leaving administration in the hands of the provincial governments, the financing of them from central funds by means of a system of grants-in-aid or by some other method ;

(c) the supplementing of the sources of revenue assigned to and collected by the provinces by certain national taxes collected by the centre on behalf of the provinces and distributed to them on some predetermined automatic basis."

The first method was rejected as it was open to certain practical and theoretical objections. It would set up internal barriers and involve varying rates of duties which can most conveniently be collected by a central authority. The plan would, again, confer on the central government the right to interfere and to compel a defaulting province to produce its contribution. And lastly, the scheme is based on the indefensible assumption that each province has a natural right to all the revenue collected within it.

Though the second method is less objectionable and more practicable, it implies central inspection and at least a limited control over local activity. When nation-building services develop on a large scale, it will require a vast bureaucracy to administer them from a single centre or even to exercise financial control. Considering the size of India and its inherent diversity, centralization of such activities, is not a practical, even if it were desirable, policy.

The third method alone, therefore, remains. For reasons given, distribution to the province of origin, does not entirely meet the necessities of the case. Of alternative methods, the only one which is at once simple, automatic and to some extent a test of "needs," is distribution in proportion to population. To distribute a large part of the revenues of India on this basis would be unfair to the provinces with a sparse population and would tend to hold back the progress of the more advanced, and by transferring resources from the richer to the poorer provinces would divorce responsibility for taxation from responsibility for spending. But though for these

reasons the method can only be used to a limited extent the haphazard character of the provinces of India and the inequalities resulting from historical accident make it necessary to introduce into the financial system of India some device that will tend to mitigate the inequalities that at present exist.

A complete scheme of allocation should, therefore, provide for the distribution of centrally collected revenues in part according to origin and in part on a population basis.

The scheme proposed for the raising and allocation of resources in accordance with these principles will be as follows:—(i) For administrative and fiscal reasons customs duty on imported liquor should be brought into relation with the excise policy of each province, since the present arrangements under which customs duties are central while provincial governments control the possession transport, purchase and sale of such liquor, have led to considerable administrative friction. The duty on imported liquor should be reduced to the standard luxury rate of thirty per cent. and the provinces should be given the right of imposing further duties in the form of excises on such liquors in accordance with their excise policy. This would involve a loss of $1\frac{1}{2}$ crores to central revenues. (ii) Revenue from commercial stamps should be transferred to the Centre. (iii) To meet the claims of the industrial provinces, one-half of the proceeds of income-tax should be assigned to the Province concerned. Super-tax would, however, continue to be entirely central since the central government, can not, at present, bear the loss which a division of this tax would involve. This will give the provinces $4\frac{1}{2}$ crores a year. (iv) To enable provinces to adjust taxation between rural and urban classes, provinces may levy a surcharge on income tax collected on the incomes of their residents, the surcharge being limited to half the tax transferred to them. (v) Exemption from income tax on agricultural incomes should be abolished by definite stages and the whole yield of this taxation should be assigned to the province of origin. (vi) Provinces should be empowered to levy terminal taxes. (vii) There should be constituted a Provincial Fund fed by specially designated taxes including (a) excise on cigarettes, (b) excise on matches and (c) duty on salt (to be transferred when the Central Budget situation permits). The resources of this fund should be automatically distributed to the provinces on a *per capita* basis. A time-table should be drawn up under which each of the above items would be transferred according to a definite schedule that would complete the transfer in ten years. Here the urgent needs of Bengal, and to a less extent of Bombay, should be recognized and the transfer of income-tax receipts should be begun as early as possible. If all the proposals embodied in the scheme are carried out, the effect would be to add nearly forty crores to the Revenue of the provinces by 1940 of which twelve crores would have been transferred from the Central Budget. The proposal to assist the Provinces by means of the Provincial Fund is described as essentially a federal idea, and the importance of finding means of harmonising the financial policy of the States and of British India is emphasised.

It should be noted that consistently with the proposal of the Commission as regards constitutional development, the above financial scheme excludes Burma from its operation. Economically and nationally speaking, this is an undesirable and retrograde step.

Instead of dividing the revenues of India, as at present, into two sharply defined classes, Mr. Layton considers them under four heads, viz.

(a) Revenue collected and spent by the central government ;

(b) Revenue collected and spent by provincial governments ;

(c) Revenue collected by the central government and distributed to the provinces according to the province of origin ;

(d) Revenue collected by the central government and distributed to the provinces on the basis of population.

He expects that the revenues of British India, excluding Burma, as regards the first of the above categories, will show a surplus. Customs will grow by $\frac{3}{4}$ crore a year to $7\frac{1}{2}$ crores at the end of the decade. Income tax will rise by at least 4 crores. Army expenditure should drop to 52 crores (49 crores excluding Burma) in 1933. But an equal amount of 3 crores will have to be added to the civil expenditure of the central government (now 15 crores). Army expenditure should be reduced to 48 crores in 1940, of which 3 crores may be chargeable to Burma. Little increase is expected from Railway receipts, as their growth will be offset by the charge of redemption of debt.

It thus appears that there will be a surplus of $16\frac{1}{2}$ crores at the end of ten years on the existing basis of taxation. A substantial allocation of revenues to the provinces will thereby be rendered possible.

The situation of the provinces as a whole (excluding Burma) at the end of ten years under the new proposed scheme and on the basis of the assumed yield of taxes, will be as follows :—

	crores
Present Revenue (1929–30 Budget)	78
Group (b)	
Surcharge on personal Income tax	3
Terminal Taxes ... ... (say)	8
Group (c)	
Half of personal income tax transferred from the centre ...	6
Agricultural Income Tax	5
Group (d)	
Provincial Fund	14
Total ...	114

The Central Budget at the end of the decade after the proposed allocations have been made, would be as follows :—

(In crores of rupees)

Revenue			*Expenditure.*	
Customs (after allowing for loss of portion of liquor duties) ...		54	Defence (reduced by 7 crores and 3 transferred to Burma) ...	45
Income Tax	20		Debt	10
Less allocated to provinces	6...	14	Civil Administration ...	13
Commercial Stamps ...		2	Cost of Coll ction ...	3
Salt (transferred)		Nil	Civil Works ...	$2\frac{1}{2}$
Opium		Nil	Other (including pensions) ...	$3\frac{1}{2}$
Railways	9		Surplus ...	$4\frac{1}{2}$
Less additional sinking fund and interest charges	3...	6		
Miscellaneous ...		$5\frac{1}{2}$		
Tatal		$81\frac{1}{2}$	Total ...	$81\frac{1}{2}$

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(*The figures refer to pages.*)